IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 1039

CHICAGO, TERRE HAUTE AND SOUTHEASTERN RAILWAY COMPANY, *et al.*,
Petitioners,

vs.

GROUP OF INSTITUTIONAL INVESTORS, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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(For Names of Other Petitioners See Inside Cover)

March 2, 1942

THE TWENTIETH CENTURY PRESS, INC., CHICAGO

Petitioners (Continued)

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioners respectfully show:

SUMMARY STATEMENT OF THE MATTER INVOLVED

This is a proceeding for the reorganization of a railroad under section 77 of the Bankruptcy Act (11 U. S. C. A. §205). The debtor, Chicago, Milwaukee, St. Paul and Pacific Railroad Company, filed its petition for reorganization on June 29, 1935, with the District Court of the

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United States for the Northern District of Illinois (R. 2), and on the same day the District Court approved the petition as properly filed (R. 42). Subsequently, the Interstate Commerce Commission approved and certified to the District Court (R. 243, 245) a plan of reorganization (R. 1319-1347). The District Court entered an order approving the plan and overruling petitioners' objections thereto (R. 1978-1992)[1]. Petitioners appealed to the Circuit Court of Appeals for the Seventh Circuit (R. 2016), which reversed the District Court, with directions to set aside the order and remand the case to the Interstate Commerce Commission (R. 2321-2322). This petition is filed because of a possible construction of the judgment of the Circuit Court of Appeals which is adverse to these petitioners.

The fundamental question presented by this petition is whether the rejection of a railroad lease in the reorganization of the lessee must take effect by relation as of the date of the filing of the debtor's petition, rather than as of a date long subsequent to the beginning of the proceeding. The issue involved relates only to the rights of the lessor upon rejection of the lease. It in no way deals with, and is not affected by, the treatment to be accorded creditors of the debtor in the readjustment of their claims.

Petitioner Chicago, Terre Haute and Southeastern Railway Company (hereinafter referred to as the "Terre Haute") is a railroad corporation organized in the year 1910 under the laws of the State of Indiana and is the owner of approximately 360 miles of railroad extending from Chicago Heights, Illinois, to Westport, Sullivan and Oolitic, Indiana (R. 1861, 2163-2164). It is not

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[1] Petitioners' objections appear at R. 1373, 1393, 1414, 1434, 1438, 1465, 1477, 1480, 1901-1903.

a debtor in this proceeding, nor is it in bankruptcy reorganization or any state or federal receivership (R. 1876, 2158). Its presence in this proceeding arises out of the fact that it is the lessor of a line of railroad to the debtor and the further fact that the reorganization plan approved by the Interstate Commerce Commission and the District Court proposed to reject the present lease and to offer for the acceptance of the Terre Haute and its bondholders a new lease on prescribed terms (R. 1330-1331). Petitioners other than the Terre Haute are the trustees under the four mortgages securing Terre Haute bonds[2], two protective commit-

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[2] Mercantile National Bank of Chicago and Benjamin H. Rubenzik, trustees under the mortgage securing the Bedford Belt Railway Company First Mortgage 5% bonds, due July 1, 1938, constituting a first mortgage on 4.66 miles of the Terre Haute lines. $250,000 principal amount of bonds are outstanding. (R. 2169.)

Girard Trust Company, trustee under the mortgage securing the Southern Indiana Railway Company First Mortgage 4% bonds, due February 1, 1951, constituting a first mortgage on 240.92 miles of the Terre Haute lines and a second mortgage on the property subject to the Bedford Belt mortgage. $7,287,000 principal amount of bonds are outstanding. (R. 2169-2170.)

Continental Illinois National Bank and Trust Company of Chicago, trustee under the mortgage securing Chicago, Terre Haute and Southeastern Railway Company First and Refunding Mortgage 5% bonds, due December 1, 1960, constituting a first mortgage on 115.17 miles of the Terre Haute lines and a junior mortgage on the properties subject to the Bedford Belt and Southern Indiana mortgages. $8,056,000 principal amount of bonds are outstanding. (R. 2169-2170.)

The First National Bank of Chicago, trustee under the mortgage securing Chicago, Terre Haute and Southeastern Railway Company 5% Income Mortgage Bonds, due December 1, 1960, constituting a junior mortgage on the properties subject to the First and Refunding Mortgage. $6,336,000 principal amount of bonds are outstanding. (R. 2169-2170.)

tees for holders of Terre Haute bonds[3], and two insurance companies owning Terre Haute bonds[4].

On July 1, 1921, the Terre Haute leased its entire property for a term of 999 years to the Chicago, Milwaukee and St. Paul Railway Company, the predecessor of the debtor herein (R. 2163). The lessee agreed to pay an amount equal to the interest on the bonds of the Terre Haute[5], the principal of such bonds at maturity, the expense of maintaining the Terre Haute's corporate existence (not in excess of $12,000 a year), and all taxes, and also agreed to perform the covenants of the Terre Haute bonds and mortgages and to maintain and replace the Terre Haute equipment[6]. On

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[3] Terre Haute First Lien Bondholders Committee, representing $1,704,000 principal amount of the First and Refunding bonds, $804,000 principal amount of the Southern Indiana bonds and $31,000 principal amount of the Bedford Belt bonds (R. 1716); and Terre Haute Income Mortgage Bondholders' Committee, representing at the time of the District Court hearing $199,100 principal amount of the Income Mortgage bonds (R. 1719), and at the present time $822,900 principal amount.

[4] Massachusetts Mutual Life Insurance Company, owner of $200,000 principal amount of the Southern Indiana bonds and $500,000 principal amount of the Income Mortgage bonds (R. 1439); and The Prudential Insurance Company of America, owner of $500,000 principal amount of the First and Refunding bonds and $500,000 principal amount of the Income Mortgage bonds (R. 1719).

[5] Annual interest requirements aggregate $1,023,580 (R. 2169).

[6] The lease was introduced in evidence before the Interstate Commerce Commission as Debtor's Exhibit 63 (R. 283). Such exhibits, and the exhibits introduced in evidence before the District Court, are a part of the record, but are not included in the printed transcript.

Under the terms of the lease the Terre Haute is required, upon its termination, to repay the amount of principal payments made by the lessee, but such repayment may be made in bonds of the Terre Haute at par.

January 14, 1928, the debtor acquired the properties of the lessee in connection with the reorganization of that company and adopted the lease pursuant to authorization granted by the Interstate Commerce Commission in *Chicago, Milwaukee & St. Paul Reorganization,* 131 I. C. C. 673, 700 (R. 2162-2163).

Since the institution of this proceeding the debtor and its trustees, who took office on January 1, 1936, have held possession of and operated the Terre Haute properties (R. 2156), but have not elected either to adopt or reject the lease (R. 1510). Orders entered by the District Court have from time to time extended the time within which such election might be made (R. 46, 84, 91, 121, 144, 164, 197, 198, 210, 232, 1351), and have enjoined all persons from interfering with, disturbing or taking possession of any portion of the assets, railroads or properties in the possession of the debtor or its trustees (R. 48, 80). During this period the current interest on the Terre Haute bonds has been paid (R. 2169) pursuant to an order of the District Court which provides that it shall not affect the right to disaffirm the lease (R. 75), but the provisions of the lease requiring payment at maturity of the principal of the Terre Haute bonds[7] and replacement of Terre Haute equipment[8] have not been performed (R. 193, 2170).

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[7] The District Court ordered the debtor's trustees not to pay the principal of the Bedford Belt bonds at their maturity on July 1, 1938, but to continue interest payments thereon (R. 193).

[8] As of the date of the filing of the debtor's petition (June 29, 1935), defaults with respect to the obligation to replace retired equipment amounted to approximately $5,000,000, and as of December 31, 1937, the amount of these equipment vacancies had increased to $7,106,149. (R. 2170.) During the period from July 1, 1935, to June 30, 1940, there were retired and not replaced 896 units of equipment, including one steam locomotive, 718 coal cars and 151 flat cars. (Terre Haute District Court Exhibit 24, introduced at R. 1688-1689.)

The reorganization plan approved by the Interstate Commerce Commission and the District Court proposes the making of a new lease upon terms more favorable to the lessee than those of the present lease, with corresponding modifications of the Terre Haute bonds and mortgages[9]. Acceptance by the Terre Haute bondholders of the proposal is a prerequisite to the making of such a new lease, since neither the Interstate Commerce Commission nor the court has jurisdiction in this proceeding to impose the proposed modifications upon the lessor and its bondholders against their will. Recognizing this, the plan provides that after confirmation by the District Court the proposal shall be submitted to the Terre Haute bondholders for acceptance or rejection. It further provides that if the court thereafter determines that the proposal has not been accepted by substantially all of those bondholders the existing lease "shall be rejected, in so far as the plan herein approved is concerned, *as of the date of such determination by the court.*" (Italics ours.) (R. 1330-1331.)

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[9] The proposal consists of extension of all bond maturities to July 1, 1989; reduction of all bond interest to 2¾% per annum fixed and 1½% per annum contingent (the contingent interest being payable on the basis of system income only after payment of all fixed charges of the reorganized company and appropriation of $2,500,000 annually for capital expenditures); waiver of all equipment vacancies to July 1, 1939, and modification of the covenants relating to replacement of equipment retired in the future; nullification of the Milwaukee's guarantee of the Terre Haute Income Mortgage Bonds; the making of provision to permit abandonment of Terre Haute property when to the advantage of the Milwaukee system; and the making of provisions to facilitate the consolidation of the Terre Haute properties with those of the Milwaukee. (R. 1330-1331.)

This provision that the rejection of the lease shall take effect as of a future date would require that the lessor's claim for damages for breach of the lease be measured as of that date and that the operation of the leased lines from the beginning of the reorganization proceeding until that date be for the account of the debtor's estate rather than for the account of the lessor.

Petitioners objected to this feature of the plan in the District Court because of its violation of the established principle that rejection of a railroad lease in reorganization takes effect as of the date of the institution of the reorganization proceeding, that damages for the breach are measured as of that date, and that the operation of the leased line after that date is for the account of the lessor, which is chargeable with all losses and entitled to any profits. In its order approving the plan the District Court overruled petitioners' objections (R. 1990).

On appeal to the Circuit Court of Appeals petitioners attacked this ruling and on that ground, among others, sought reversal of the District Court's order of approval (R. 2025, 2031-2032). The opinion of the Circuit Court of Appeals makes no reference to this issue. Its judgment, so far as material, reads as follows (R. 2321-2322):

> "• • • it is ordered, adjudged and decreed by this Court that the order or decree of the said District Court in this cause appealed from be, and the same is hereby, reversed, and that this cause be, and it is hereby, remanded to the said District Court with directions to set aside the District Court's order of approval and to remand the case to the Interstate Commerce Commission for the making of findings, and, if necessary, the taking of additional evidence, that additional findings may be made, as indicated in the opinion of this Court filed herein; and that each party will pay its own costs in this Court."

On its face this judgment is favorable to petitioners, as the reversal of the order of the District Court constitutes the ultimate relief which they sought. The judgment, however, directs the District Court to remand the case to the Interstate Commerce Commission for the making of findings, and, if necessary, the taking of additional evidence, that additional findings may be made. It does not direct that rejection of the lease, if it occurs, must take effect as of the date of the institution of the proceeding, and it might be contended that as a result of this silence the judgment is adverse to petitioners on that issue. While we believe that such a construction of the judgment would be erroneous, we recognize that it is possible, and this petition is filed to review the judgment if it is so construed[10].

STATUTE INVOLVED

The pertinent provisions of section 77 of the Bankruptcy Act (11 U. S. C. A. § 205) are reproduced as an appendix, *infra*, page 22.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 4, 1941 (R. 2318, 2321-2322). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A. § 347).

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[10] The alternative construction of the judgment is dealt with in the brief filed contemporaneously herewith by these petitioners in opposition to the Petition of Group of Institutional Investors and Mutual Savings Bank Group for Writs of Certiorari, Nos. 875-883.

QUESTIONS PRESENTED

1. May a plan of reorganization for a lessee of a line of railroad, which provides for rejection of the lease, lawfully require that the rejection shall take effect as of a date other than, and subsequent to, the date on which the reorganization proceeding was instituted?

2. May such a plan lawfully require that the lessor's claim for damages shall be measured as of a date other than the date on which the reorganization proceeding was instituted?

3. May such a plan lawfully require that the operation of the leased property shall be for the account of the debtor's estate, rather than for the account of the lessor, after the date on which the reorganization proceeding was instituted?

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT

This petition is filed to review the judgment below if construed as decreeing that the plan of reorganization may provide that rejection of the lease shall take effect as of a date subsequent to the date on which the proceeding was instituted. The following statement of reasons relied on for the allowance of the writ assumes that the judgment is properly so construed. The reasons are:

(1) The judgment, if so construed, decides a question as to the construction of the federal Bankruptcy Act with respect to the measure of the lessor's claim for damages in a way probably in conflict with the decision of this Court in *Connecticut Ry. Co.* v. *Palmer*, 305 U. S. 493.

(2) The judgment, if so construed, decides a question under the federal Bankruptcy Act with respect to the right to net earnings and the liability for losses from operation of the leased line during the proceeding in a way probably in conflict with the decision of this Court in *Palmer* v. *Webster & Atlas Bank*, 312 U. S. 156.

(3) The judgment, if so construed, is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *Palmer* v. *Palmer*, 104 F. (2d) 161, with respect to the right to net earnings and the liability for losses from operation of the leased line during the proceeding.

WHEREFORE, your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the Circuit Court of Appeals for the Seventh Circuit, commanding that court to certify and send to this Court for its review and determination, on a date certain to be therein named, a full and complete transcript of the record and of all of the proceedings in the case numbered on its docket No. 7614 and entitled "In the Matter of Chicago, Milwaukee, St. Paul & Pacific Railroad Company, Debtor; Chicago, Terre Haute & Southeastern Ry. Co., Income Mortgage Bondholders' Committee, et al., Appellants, vs. Group of Institutional Investors, etc., et al., Appellees," and that the judgment herein of said Circuit Court of Appeals for the Seventh Circuit be modified and the case remanded with directions to instruct the Interstate Commerce Commission that rejection of the Terre Haute lease, if it occurs, must take effect as of the date of the institution of the reorganization proceed-

ing, and that your petitioners may have such other and further relief in the premises as to this Court may seem proper.

Dated March 2, 1942.

Respectfully submitted,

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BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

OPINIONS BELOW

The reports and orders of the Interstate Commerce Commission are reported in 239 I. C. C. 485 and 240 I. C. C. 257. (Original Report, R. 2153-2269, and Order, R. 1258-1283; Supplemental Report, R. 1284-1317, and Order, R. 1319-1347.) The opinion of the District Court is reported in 36 F. Supp. 193 (R. 1857-1899). The opinion of the Circuit Court of Appeals is reported in 124 F. (2d) 754 (R. 2297-2317, 2334-2335).

JURISDICTION

A statement of the jurisdiction has been given in the petition (p. 8) and, to avoid duplication, is not repeated.

STATEMENT OF THE CASE

A statement of the case has been given in the petition (pp. 1-8) and, to avoid duplication, is not repeated.

SPECIFICATION OF ERRORS INTENDED TO BE URGED

1. The Circuit Court of Appeals erred in not directing the District Court to remand the case to the Interstate Commerce Commission with instructions that rejection of the Terre Haute lease, if it occurs, must take effect as of the date on which the reorganization proceeding was instituted.

2. The Circuit Court of Appeals erred in not directing the District Court to remand the case to the Interstate Commerce Commission with instructions that, in the event of rejection of the Terre Haute lease, the lessor's claim for damages must be measured as of the date on which the reorganization proceeding was instituted.

3. The Circuit Court of Appeals erred in not directing the District Court to remand the case to the Interstate Commerce Commission with instructions that, in the event of rejection of the Terre Haute lease, the operation of the leased property after the date on which the reorganization proceeding was instituted must be for the account of the lessor.

SUMMARY OF ARGUMENT

I

Under the decision of this Court in *Connecticut Ry. Co.* v. *Palmer,* 305 U. S. 493, construing subdivision (b) of section 77, the lessor's claim for damages, in the event of rejection of the lease, must be measured as of the date on which the reorganization proceeding was instituted. The judgment below, if construed as decreeing that a later date may be used, is in conflict with that decision.

II

Under the decision of this Court in *Palmer* v. *Webster & Atlas Bank,* 312 U. S. 156, and the decision of the Circuit Court of Appeals for the Second Circuit in *Palmer* v. *Palmer,* 104 F. (2d) 161, the operation of the leased line, if the lease is rejected, must be held to have been for the account of the lessor from the date on which the reorganization proceeding was instituted. The judgment below, if construed as decreeing that the operation shall be held to have been for the account of the debtor's estate for any period after that date, is in conflict with those decisions.

ARGUMENT

I

The decision of this Court in Connecticut Ry. Co. v. Palmer, 305 U. S. 493, establishes that in the event of rejection the lessor's damages must be measured as of the date on which the reorganization proceeding was instituted.

The rule applicable to the determination of a lessor's damages, in the event of rejection of the lease, is prescribed by subdivision (b) of section 77, wherein it is provided (11 U. S. C. A. § 205 (b)):

> "In case an executory contract or unexpired lease of property shall be rejected, or shall not have been adopted by a trustee appointed under this section, or shall have been rejected by a receiver in equity in a proceeding pending prior to the institution of a proceeding under this section, or shall be rejected by any plan, any person injured by such nonadoption or rejection shall for all purposes of this section be deemed to be a creditor of the debtor to the extent of the actual damage or injury determined in accordance with principles obtaining in equity proceedings."

In *Connecticut Ry. Co.* v. *Palmer,* 305 U. S. 493, 502, 504-505, this Court held that the foregoing provision places leases upon the same basis as executory contracts and that the damages for breach of a lease are to be determined by the rules applicable to executory contracts, saying (p. 502):

> "As reorganizations had been traditionally carried on in equity and would be carried on in a bankruptcy court with equity powers, it was natural to add the clause as to equitable proceedings. Leases were placed upon the same basis as executory contracts."

This decision requires that in section 77 proceedings the lessor's claim for damages must be measured as of the date of the institution of the proceeding. *In re New York, N. H. & H. R. Co.*, 30 F. Supp. 541, 543; *Pennsylvania Steel Co.* v. *New York City Ry. Co.*, 198 Fed. 721, 735, 744.

The reorganization plan in the instant case, however, requires that rejection of the Terre Haute lease shall take effect as of a date which is as yet undetermined but which will necessarily be long subsequent to the institution of the proceeding and thereby requires that the lessor's damages shall be measured as of that later date. Accordingly, the judgment of the Circuit Court of Appeals, if construed as approving that provision of the plan, conflicts with the decision of this Court in *Connecticut Ry. Co.* v. *Palmer*, 305 U. S. 493.

II

The decisions of this Court in Palmer v. Webster & Atlas Bank, 312 U. S. 156, and of the Second Circuit Court of Appeals in Palmer v. Palmer, 104 F. (2d) 161, establish that in the event of rejection of a railroad lease, operation of the leased line after the date on which the proceeding is instituted is for the account of the lessor.

In equity reorganizations it is settled that a receiver of a lessee of a line of railroad is in no way bound by the lease, even though he operates the leased property, unless the lease is adopted. In that event the adoption takes effect as of the beginning of the proceeding, and both the receiver and the lessor are bound by the terms of the lease. Similarly, if the lease is rejected, the rejection takes effect as of the beginning of the receivership and neither the receiver nor the lessor can claim any rights against the other by reason of the lease. In the case of rejection,

therefore, the receiver's operation of the leased line is held to be for the account of the lessor from the beginning of the receivership, and the lessor is liable for all losses and entitled to receive all net earnings.

Pennsylvania Steel Co. v. *New York City Ry. Co.*, 198 Fed. 721, 729-731;
Westinghouse Electric & Mfg. Co. v. *Brooklyn Rapid T. Co.*, 6 F. (2d) 547, 549-550;
American Brake Shoe & Foundry Co. v. *New York Rys. Co.*, 282 Fed. 523, 529;
Mercantile Trust Co. v. *Farmers' Loan & Trust Co.*, 81 Fed. 254, 258 (cert. den. 168 U. S. 710).

The applicability of this principle to section 77 proceedings is impliedly recognized by subdivision (c) (6) of the statute and is established by the decision of this Court in *Palmer* v. *Webster & Atlas Bank*, 312 U. S. 156, and by the decision of the Second Circuit Court of Appeals in *Palmer* v. *Palmer*, 104 F. (2d) 161.[1]

Section 77 (c) (6) reads as follows (11 U. S. C. A. § 205 (c) (6)):

> "If a lease of a line of railroad is rejected, and if the lessee, with the approval of the judge, shall elect no longer to operate the leased line, it shall be the duty of the lessor at the end of a period to be fixed by the judge to begin the operation of such line, unless the judge, upon the petition of the lessor, shall decree after hearing that it would be impracticable and contrary to the public interest for the lessor to operate the said line, in which event it shall be the duty of the lessee *to continue* operation on or for the account of

[1] The applicability of the principle is also recognized, by way of dictum, in a decision of the Circuit Court of Appeals for the Seventh Circuit. *In re Chicago, R. I. & P. Ry. Co.*, 110 F. (2d) 395, 399.

> the lessor until the abandonment of such line is authorized by the Commission in accordance with the provisions of section 1 of the Interstate Commerce Act as amended." (Italics ours.)

In *Palmer* v. *Webster & Atlas Bank*, 312 U. S. 156, this Court upheld as the exercise of a sound discretion action of a District Court which it recognized (312 U. S. at page 162) had been based in part upon application of the principle that rejection relates back to the date of the debtor's petition and that after that date operation is for the account of the lessor.

In *Palmer* v. *Palmer*, 104 F. (2d) 161, the Circuit Court of Appeals for the Second Circuit held that the rejection of a railroad lease by the lessee's trustees related back to the date on which the proceeding was instituted and that the operation of the leased line was for the account of the lessor after that date.

The reorganization plan in the instant case provides that rejection of the Terre Haute lease shall take effect as of a date which will necessarily be more than six years subsequent to the institution of the proceeding. This requires that the operation of the leased property during that period shall be for the account of the debtor's estate and not for the account of the lessor, thereby depriving the lessor of its right to an accounting of the net earnings from the beginning of the proceeding. This is contrary to the established principle that rejection relates back to the date of the petition for reorganization and that operation after that date is for the account of the lessor. Ac-

cordingly, the judgment of the Circuit Court of Appeals, if construed as approving this provision of the plan, is in conflict with the decision of this Court in *Palmer* v. *Webster & Atlas Bank*, 312 U. S. 156, and with the decision of the Circuit Court of Appeals for the Second Circuit in *Palmer* v. *Palmer*, 104 F. (2d) 161.

Inasmuch as our petition is directed at a possible interpretation of the judgment below which is adverse to our contention that the rule is that rejection takes effect as of the date of the institution of the proceeding, it is inappropriate here to discuss a qualification of the rule which our opponents assert exists in cases where there are present facts giving rise to special equities which might create an estoppel against application of the rule in a particular case. See *Pennsylvania Steel Co.* v. *New York City Ry. Co.*, 198 Fed. 721, 730; *Palmer* v. *Palmer*, 104 F. (2d) 161, 164. That question is discussed in the brief filed by these petitioners in reply to the Petition of Group of Institutional Investors and Mutual Savings Bank Group for Writs of Certiorari, in Nos. 875-883, in which we deal with the alternative construction of the judgment below, namely, that it accepts the general rule of relation back and requires the Interstate Commerce Commission to make findings of fact with respect to the existence of special equities.

Respectfully submitted,

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APPENDIX.

The pertinent provisions of section 77 of the Bankruptcy Act (11 U. S. C. A. § 205) are as follows:

"(a) Any railroad corporation may file a petition stating that it is insolvent or unable to meet its debts as they mature and that it desires to effect a plan of reorganization. • • • Upon the filing of such a petition, the judge shall enter an order either approving it as properly filed under this section, if satisfied that such petition complies with this section and has been filed in good faith, or dismissing it, if he is not so satisfied. If the petition is so approved, the court in which such order is entered shall, during the pendency of the proceedings under this section and for the purposes thereof, have exclusive jurisdiction of the debtor and its property wherever located, and shall have and may exercise in addition to the powers conferred by this section all the powers, not inconsistent with this section, which a Federal court would have had if it had appointed a receiver in equity of the property of the debtor for any purpose. • • •

"(b) A plan of reorganization within the meaning of this section • • • may reject contracts of the debtor which are executory in whole or in part, including unexpired leases; and may include any other appropriate provisions not inconsistent with this section.

"The adoption of an executory contract or unexpired lease by the trustee or trustees of a debtor shall not preclude a rejection of such contract or lease in a plan of reorganization approved hereunder, and any claim resulting from such rejection shall not have priority over any other claims against the debtor because such contract or lease had been previously adopted.

• • • The term 'creditors' shall include, for all purposes of this section all holders of claims of whatever character against the debtor or its property, whether or not such claims would otherwise constitute provable claims under this Act, including the holder of a claim

under a contract executory in whole or in part including an unexpired lease.

"• • • In case an executory contract or unexpired lease of property shall be rejected, or shall not have been adopted by a trustee appointed under this section, or shall have been rejected by a receiver in equity in a proceeding pending prior to the institution of a proceeding under this section, or shall be rejected by any plan, any person injured by such nonadoption or rejection shall for all purposes of this section be deemed to be a creditor of the debtor to the extent of the actual damage or injury determined in accordance with principles obtaining in equity proceedings. • • •

"(c) After approving the petition:

• • •

"(6) If a lease of a line of railroad is rejected, and if the lessee, with the approval of the judge, shall elect no longer to operate the leased line, it shall be the duty of the lessor at the end of a period to be fixed by the judge to begin the operation of such line, unless the judge, upon the petition of the lessor, shall decree after hearing that it would be impracticable and contrary to the public interest for the lessor to operate the said line, in which event it shall be the duty of the lessee to continue operation on or for the account of the lessor until the abandonment of such line is authorized by the Commission in accordance with the provisions of section 1 of the Interstate Commerce Act as amended."

34

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

Nos. ~~1064~~ and ~~1065~~ 52-53

IN THE MATTER OF

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY

All *Debtor*

GUARANTY TRUST COMPANY OF NEW YORK, ETC., AS FIFTY YEAR MORTGAGE TRUSTEES

Petitioners

v.

GROUP OF INSTITUTIONAL INVESTORS, ETC., *et al.*

Respondents

E. STANLEY GLINES, ETC., AS FIFTY YEAR MORTGAGE PROTECTIVE COMMITTEE

Petitioners

v.

GROUP OF INSTITUTIONAL INVESTORS, ETC., *et al.*

Respondents

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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Dated March 21, 1942

IN THE

Supreme Court of the United States

October Term, 1941

In the Matter of

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY

Debtor

GUARANTY TRUST COMPANY OF NEW YORK, etc., as FIFTY YEAR MORTGAGE TRUSTEES
Petitioners

v.

GROUP OF INSTITUTIONAL INVESTORS, etc., *et al.*
Respondents

Nos.

and

E. STANLEY GLINES, etc., as FIFTY YEAR MORTGAGE PROTECTIVE COMMITTEE
Petitioners

v.

GROUP OF INSTITUTIONAL INVESTORS, etc., *et al.*
Respondents

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Your petitioners are:

(1) Guaranty Trust Company of New York and Merrel P. Callaway (herein sometimes called the "Fifty Year Mortgage Trustees") as trustees under the Mortgage and Deed of Trust of Chicago, Milwaukee, St. Paul and Pacific Railroad Company dated as of February 2, 1925 (herein sometimes called the "Fifty Year Mortgage"), securing the Chicago, Milwaukee, St. Paul and Pacific Railroad Company Fifty Year Five Per Cent. Mortgage Gold Bonds, Series A, due February 1, 1975 (herein sometimes called the "5s of 75"); and

(2) E. Stanley Glines, Morton H. Fry, R. Harland Shaw, Charles M. Storey, and C. Oliver Wellington as a Protective Committee for holders of the 5s of 75 (herein sometimes called the "Fifty Year Mortgage Protective Committee").

For the convenience of this Court petitioners have collaborated in preparing this petition, but they are filing it severally, and in the event writs of certiorari are granted they intend to file separate briefs on the merits and to participate separately in oral argument.

Petitioners respectfully pray that a writ of certiorari be issued to review the judgments of the United States Circuit Court of Appeals for the Seventh Circuit entered December 4, 1941 in these reorganization proceedings, reversing the order of the District Court of the United States for the Northern District of Illinois, Eastern Division, which had approved the Modified Plan of Reorganization approved by the Interstate Commerce Commission and certified to the District Court, and directing the District Court to remand the proceedings to the Commission for the mak-

ing of findings, and, if necessary, the taking of additional evidence for the making of findings, as indicated in the opinion of the Circuit Court.

Reports, Orders and Opinions Below

The initial report (R. 2153-2269) and order (R. 1258-83) of the Commission decided February 12, 1940 are reported in 239 I. C. C. 485, and its supplemental report (R. 1284-1317) and supplemental order (R. 1319-47) decided June 4, 1940 are reported in 240 I. C. C. 257. The Plan of reorganization certified by the Commission to the District Court is embodied in this supplemental order, and is herein sometimes called the "Commission's Plan". The opinion of the District Court dated October 21, 1940 (R. 1857-99) is reported in 36 F. Supp. 193; its findings of fact, conclusions of law, order and decree entered November 13, 1940 appear at R. 1978-92. The opinion of the Circuit Court dated December 4, 1941 (R. 2297-2317) is reported in 124 F. (2d) 754; its judgments entered the same day appear at R. 2318-24. Its memorandum opinion dated January 12, 1942 and order entered the same day, denying a motion to modify its original opinion, appear at R. 2334-5; this memorandum opinion is not yet reported.

Jurisdiction

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A. § 347(a)) and Section 24(c) of the Bankruptcy Act as amended (11 U. S. C. A. § 47(c)). The judgments of the Circuit Court were entered December 4, 1941 (R. 2318-24).

Statute Involved

The issues involve the construction and application to the facts of this case of Section 77 of the Bankruptcy Act as amended (11 U. S. C. A. § 205). Relevant portions thereof are printed as an Appendix (pp. 57-63) to the petition for writs of certiorari dated January 17, 1942 and filed with this Court by the Group of Institutional Investors (herein sometimes called the "Group") and the Mutual Savings Bank Group (herein together sometimes called the "Groups") in Causes Nos. 875-883, present Term, wherein review of these same judgments is sought. In the interests of economy that material is not reprinted here.

Summary Statement of the Matter Involved

The nature of these proceedings is summarized as to the facts in the aforementioned January 17, 1942 petition of the Groups for writs of certiorari (pp. 3-7), and to save the time of this Court is not repeated here.* Petitioners do not, however, subscribe to the implication arising from the Groups' phraseology that either the record or the consideration thus far given to the problems inherent in these proceedings is sufficient for the formulation of a fair and equitable plan of reorganization.

As regards the primary issues involved, furthermore, the position of petitioners differs in marked respect from

*It is respectfully requested that the certified transcript of record and additional printed copies that were filed with the petition of the Groups be deemed to accompany this petition within the meaning of Rule 38 of the Revised Rules of Procedure of the Supreme Court of the United States, and that reference may be made thereto accordingly.

that taken by the Groups. Petitioners were appellants before the Circuit Court; the Groups were appellees. From a procedural standpoint, therefore, petitioners obtained the relief requested of the Circuit Court by them. But the more important issues raised by petitioners were left undecided. These issues are fundamental, and an authoritative determination thereof is essential to the formulation of a fair and equitable plan of reorganization of the Debtor.

In order to expedite the progress of these reorganization proceedings, petitioners do not object to the granting of the writs requested by the Groups. Indeed, the fourth question presented in the petition of the Groups (p. 12), namely, as to whether the order of approval of the District Court should be affirmed, seems of necessity to require a determination of the questions hereinafter presented and on which the Circuit Court failed to express any views. In an effort to be specific, however, and to bring these issues squarely to the fore, this petition is being filed.

There have been duly issued under the Fifty Year Mortgage and are now outstanding $106,395,096 principal amount of 5s of 75. No interest has been paid thereon during these reorganization proceedings, and the total claim of the holders of 5s of 75 now exceeds $143,000,000. The 5s of 75 rank immediately junior to the $8,665,000 principal amount of bonds issued under the First and Refunding Mortgage of Chicago, Milwaukee, St. Paul and Pacific Railroad Company dated as of February 2, 1925, all of which are pledged as partial security for Reconstruction Finance Corporation loans now amounting to less than $10,800,000. Interest on these loans has been paid currently during these reorganization proceedings. The First and Refunding Bonds are amply secured by various bonds and stocks pledged under the First and Refunding Mort-

gage. Accordingly the 5s of 75 are secured by what is for all practical purposes a first lien on the Lines West, extending from Mobridge, South Dakota, to the Pacific Coast and comprising over 2,800 miles (I. C. C. Ex. 91), and by a second lien on the Lines East, comprising roughly the two-thirds of the main-line mileage east of the Missouri River. There are also other substantial items of underlying security.

The Fifty Year Mortgage Trustees have participated in these reorganization proceedings throughout their course; the Fifty Year Mortgage Protective Committee, formed as the result of a meeting of holders of 5s of 75 called in February of 1938 by the Fifty Year Mortgage Trustees, is the only committee representing the 5s of 75 exclusively or primarily.

The questions at issue far transcend in importance matters of difference as to the allocation of securities and the details of reorganization. Because of the importance of the subject, explicit directions to the subordinate courts and to the Interstate Commerce Commission are essential to the orderly maintenance of the transportation of the United States. This writ is asked in order to secure such a consideration from the final authority in the interpretation of Section 77 of the Bankruptcy Act.

Questions Presented

1. Can liens be destroyed and junior securities allotted to first lienors in the reorganization of a major railroad without the making of thorough and comprehensive studies of the worth of the mortgage districts involved?

2. Can holders of bonds secured by a first lien on approximately one-third of the mileage and one-third of

the depreciated reproduction value of an entire railroad system be forced to take the bulk of their claim in new stock merely on the basis of results shown by a perfunctory segregation of revenues and expenses admittedly made for the purposes of a moratorium or "stand-by" plan only?

3. Does the public interest, or any other factor, require that large amounts of first-lien, fixed-interest debt be converted into stock rather than into contingent-interest securities?

4. In determining whether the new securities to be issued to holders of existing securities pursuant to a plan of reorganization constitute full and adequate compensation for the rights surrendered, is it not necessary to make a realistic appraisal of the worth of such new securities?

5. In a proposed capital structure that does not permit satisfaction in full of the claims of senior creditors on the basis of any realistic appraisal of the worth of the new securities offered in exchange, are junior creditors permitted to share in such new securities?

6. Is the treatment proposed for the holders of 5s of 75 in the Commission's Plan fair and equitable and in conformity with the requirements of the law of the land?

7. Should not the Commission, in the event these proceedings are remanded to it for further proceedings in accordance with Section 77 of the Bankruptcy Act as amended, be required to bring the record up to date?

Reasons Relied on for Allowance of the Writ

The issues in these proceedings present important questions of federal law that have not, and should be, passed

upon by this Court. An authoritative determination thereof is essential to the formulation of any fair and equitable plan of reorganization of the Debtor, and accordingly the proper construction and application of Section 77 of the Bankruptcy Act as amended should be given at this time in order to expedite the consummation of this reorganization and to prevent unnecessary delay in the future course of these already lengthy proceedings. The almost unique course of the instant proceedings, especially when taken in conjunction with the dicta in the opinion of the Circuit Court made in spite of its expressed inability to determine the fairness of the Commission's Plan, is at variance with the procedure and criteria observed in other proceedings of this sort.

The issues go far deeper than the mere question of making formal findings, however. Before any valid findings can be made at all, there must be proper evidence upon which to base them. Regardless of the form in which findings are presented, the basing of allocations, or of findings leading thereto, on assumption and inadequate data makes illusory the protection of investors apparently afforded by Section 77. Approval of the Commission's Plan on the basis of the record in these proceedings would strongly indicate that the careful and comprehensive studies made in other comparable proceedings for the reorganization of railroads were in a large degree unnecessary, and accordingly such approval would have an exceedingly harmful effect on the thoroughness with which the basic evidence is presented in various pending and future proceedings of this sort.

Furthermore, it seems obvious that no determination of fair compensation for rights taken away can be made

without a realistic and reasonably accurate appraisal of the worth of the new securities offered in exchange. The propriety of arbitrary and unnecessary conversion of first-lien bonds into stock on a large scale should be given authoritative consideration; if not only the lien but also the possibility of receiving income admittedly earned can be removed by this simple expedient, then the entire nature of bond investment becomes subject to totally new conceptions.

As regards the matter of bringing the record up to date in the event of further proceedings before the Commission, it is assumed that the Commission would do this in the normal course of events. It is submitted, nevertheless, that the preparation of an up-to-date record should be required as a matter of law, especially in a situation such as this, in which the relevant data of today are so vastly different from those on which the Commission's Plan is based.

The Fifty Year Mortgage Trustees and the Fifty Year Mortgage Protective Committee agree that these proceedings should be remanded to the Commission, but they urge that the basic issues presented therein be resolved, so that some guide will be available in attempting to formulate a fair and equitable plan of reorganization before the Commission. Failure to do so at this time may well expand these proceedings to an inordinate length. They also urge that, in so far as the docket of this Court permits, these proceedings be advanced on the docket in order to effect as speedy a determination of the matter by this Court as is consonant with orderly procedure.

Wherefore petitioners pray that writs of certiorari be issued to the United States Circuit Court of Appeals for the Seventh Circuit in order to permit review by this

Court of the judgments of the Circuit Court in the causes numbered 7613 and 7617 on its docket and respectively entitled "In the Matter of Chicago, Milwaukee, St. Paul & Pacific R.R. Co., Debtor, Guaranty Trust Company of New York, et al., etc., Appellants, *v.* Group of Institutional Investors, etc., et al., Appellees", and "In the Matter of Chicago, Milwaukee, St. Paul & Pacific R.R. Co., Debtor, E. Stanley Glines, et al., etc., Appellants, *v.* Group of Institutional Investors, etc., et al., Appellees"; that the judgments of the Circuit Court be so modified that these proceedings will be remanded to the Commission with specific instructions as to the aforementioned questions; and that petitioners may have such other and further relief in the premises as this Court may deem proper.

Respectfully submitted,

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Dated March 21, 1942

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 1020

H. C. ORTON, ET AL.,

Petitioners,

vs.

GROUP OF INSTITUTIONAL INVESTORS, ET AL.,

Respondents.

PETITION OF H. C. ORTON, ET AL., FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

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March 23, 1942.

THE GUNTHORP-WARREN PRINTING COMPANY, 310 WEST JACKSON, CHICAGO

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No.

H. C. ORTON, ET AL.,

Petitioners,

vs.

GROUP OF INSTITUTIONAL INVESTORS, ET AL.,

Respondents.

PETITION OF H. C. ORTON, ET AL., FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioners, H. C. Orton, Karl A. Meyer, Rucker Penn, J. B. Johnston, and D. C. Wolf, as the Protective Committee for the holders of preferred stock of Chicago, Milwaukee, St. Paul and Pacific Railroad Company, Debtor, respectfully pray the issuance of a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Seventh Circuit, entered on December 4, 1941, reversing the order of the District Court for the Northern District of Illinois, which had approved the plan of reorganization, and remanding the proceedings to the

said District Court with directions to set aside the District Court's approval and to remand the case to the Interstate Commerce Commission for the making of findings.

Summary Statement of the Matter Involved.

The Debtor, Chicago, Milwaukee, St. Paul and Pacific Railroad Company, filed its petition for reorganization under Section 77 of the Bankruptcy Act (11 U. S. C. A. 205) on June 29, 1935, with the District Court of the United States for the Northern District of Illinois (R. 2) and the petition was approved as properly filed by that Court on that same day (R. 42). Subsequently, the Interstate Commerce Commission approved and certified to the District Court a plan of reorganization on which hearings were held before the said District Court and an order entered approving the plan and overruling objections thereto, including the objections of the Preferred Stockholders Committee filed July 31, 1940 (R. 1397-1400). The order overruling the objections and the findings of fact, conclusions of law, and order and decree approving the plan were entered by the District Court on November 13, 1940 (R. 1977-1992). The Preferred Stockholders Committee appealed to the Circuit Court of Appeals (R. 2007). The said Circuit Court of Appeals on December 4, 1941, filed an opinion (R. 2297-2317) reversing the District Court and in the judgment upon such opinion the Court remanded the proceedings to the District Court with directions to set aside the District Court's order of approval and "to remand the case to the Interstate Commerce Commission for the making of findings, and, if necessary, the taking of additional evidence, that additional findings may be made, as indicated in the opinion of this Court filed herein" (R. 2320). Subsequently on December 18, 1941, your petitioners filed in the Circuit Court of Appeals a petition for modification of the opinion, seeking a striking

therefrom of three paragraphs which directly related to and affected the preferred and common stockholders of the Debtor. The Circuit Court of Appeals denied said petition on January 12, 1942, and issued a *per curiam* opinion to clarify its position (R. 2334-5).

While the actual reversal of the District Court and the remanding of the proceedings to the Interstate Commerce Commission constitute a judgment favorable to petitioners, inasmuch as the making of findings and the taking of additional evidence by the Commission is required to be predicated upon the language of the opinion of the Court, much of which language is adverse to these petitioners, we believe it necessary to file this petition in order to correct the errors found in such opinion.

Jurisdictional Statement.

The jurisdiction of this Court is invoked under the provisions of Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C. A., Section 347(a)). The judgment of the Circuit Court of Appeals sought to be reviewed was entered on December 4, 1941, and the supplementary *per curiam* opinion was filed January 12, 1942.

Questions Presented.

(1) Should the District Court have sustained the Preferred Stockholders Committee's objections to the plan of reorganization, which objections will be summarized in the brief in support of this petition?

(2) Does the plan of reorganization as approved take the property of the preferred stockholders of the Debtor without due process of law in violation of the Fifth Amendment to the Constitution of the United States?

(3) Does the plan of reorganization as approved take the property of the preferred stockholders for public use without just compensation, in violation of the Fifth Amendment to the Constitution of the United States?

(4) Does the evidence of record support the findings of the Interstate Commerce Commission, approved by the District Court and, by the language in its opinion, approved by the Circuit Court of Appeals, that the equity of the holders of the Debtor's preferred and common stock has no value?

(5) Has the Interstate Commerce Commission made sufficient finding of value of the properties of the Debtor in order to justify elimination of the preferred stockholders from participation in the plan of reorganization?

Reasons Relied on for the Allowance of the Writ.

(1) The decision in the instant case insofar as it affects the preferred stockholders and limits the matters upon which the Interstate Commerce Commission is to pass upon remanding of the proceedings thereto, directly conflicts with the holding of the Circuit Court of Appeals for the Ninth Circuit in the case of *In re The Western Pacific Railroad Company, Debtor,* 124 F. (2d) 136, handed down November 28, 1941, wherein it was held that the decree of the District Court approving the plan of reorganization must be reversed and remanded with directions to dismiss or, on motion of any party in interest, to refer the proceeding back to the Commission without restriction, in which case the Court held that without requisite valuation data, it could not exercise the "informed, independent judgment" which any appraisal of the fairness of a plan of reorganization from any aspect entailed.

(2) The holding by the Circuit Court of Appeals that

the findings of the Interstate Commerce Commission as to absence of value of the old common and preferred stock was specific, definite, and certain, and fully met the requirements for determination and certification of values, is squarely in conflict with the last paragraph of Section 77 (e) and with the decision of the Court in *Consolidated Rock Products Company* v. *DuBois,* 312 U. S. 510.

(3) The question of the correctness of complete elimination from participation in a plan of reorganization of Section 77 of the stockholders of the old company is of extreme importance and has not yet been passed upon by this Court. Whether or not such elimination is legally and equitably justified in view of all the facts and circumstances in this case, should be definitely determined by this Court, and the thousands of stockholders in railroad corporations throughout the country are entitled to an enunciation of the correct principles so that these questions may be settled once and for all.

WHEREFORE, your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the Circuit Court of Appeals for the Seventh Circuit, commanding that Court to certify and to send to this Court for its review on a day certain to be therein named, a full and complete transcript of the record and all of the proceedings in the case numbered on its docket, No. 7612, and entitled *In the Matter of Chicago, Milwaukee, St. Paul and Pacific Railroad Company, Debtor, H. C. Orton, et al., etc., Appellants* v. *Group of Institutional Investors, etc., et al., Appellees,* and that the judgment of the Circuit Court of Appeals for the Seventh Circuit may be modified by the omission therefrom of all restrictions upon the matters to be considered by the Interstate Commerce Commission, and that the decree of the District Court be reversed, the proceedings to be referred back to the Interstate Commerce Commission

for complete reconsideration under the provisions of subsection (d) of Section 77, as is provided in Section 77 (e), and for further action in conformity with the decision and determination of this Court; and that your petitioners may have such other and further relief in the premises as to this Court may seem proper.

EDWARD R. JOHNSTON,
ALBERT K. ORSCHEL,
Attorneys for H. C. Orton, et al., Petitioners.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

SUMMARY OF ARGUMENT.

I. The findings made by the Interstate Commerce Commission with respect to the absence of value of the equity of the preferred stockholders are wholly insufficient to enable the Court to determine whether or not the plan of reorganization is fair and equitable with respect to such stockholders.

II. The Interstate Commerce Commission failed to perform its statutory duty to determine and certify the values of the Debtor's properties in accordance with Section 77 (e).

III. The plan of reorganization as approved is not fair and equitable, does not afford due recognition to the rights of the preferred stockholders, and does not conform to the requirements of the law of the land.

ARGUMENT.

Since we have presented a brief statement of the case on the petition for writ of certiorari, we shall not here repeat such statement. The issues involved in the consideration of the legality and validity of the complete elimination of the preferred stockholders are many and it is not our purpose at this time to go into them in detail. We shall simply state the outstanding reasons in our opinion why the Court should hear this case, and more detailed argument will later be made on brief and in oral argument, in the event this Court sees fit to grant our petition for a writ of certiorari.

I.

The Findings Made by the Interstate Commerce Commission With Respect to the Absence of Value of the Equity of the Preferred Stockholders Are Wholly Insufficient to Enable the Court to Determine Whether or Not the Plan of Reorganization Is Fair and Equitable With Respect to Such Stockholders.

The Interstate Commerce Commission in its report approving the plan of reorganization based its opinion that the holders of the preferred stock had no equity, entirely on its views as to the earning power of the Debtor. The Commission disagreed completely with the contentions of the Debtor and the stockholders regarding the high earning power of the railroad and refused to consider any evidence of physical value. It made no finding as to the value of the assets of the company such as was necessary in order to determine whether or not those assets fell short of the amount of the debts of the company. It should be remembered that at no time has there been a finding of insolvency of the Debtor. Further, although the decision of this Court

in the *Consolidated Rock Products Company* v. *DuBois*, 312 U. S. 510, had not been announced at the time of the report and order of the Interstate Commerce Commission approving the plan, the principles of *Northern Pacific Railroad Company* v. *Boyd*, 228 U. S. 482, and of *Case* v. *Los Angeles Lumber Products Company*, 308 U. S. 106, in which it was determined that the first principles of the Boyd case applied equally to reorganizations consummated under Section 77 and 77B of the Bankruptcy Act, had been well established. The *Consolidated Rock Products* case, *supra*, has completely settled the necessity of a trustworthy appraisal of the assets of the Debtor. Since it was upon the basis of that latter case that the Circuit Court of Appeals below reversed the District Court's approval of the plan, we feel that the preferred stockholders are as entitled as any other parties to the protection of such principles. The capitalization of prospective earnings attempted to be made by the Interstate Commerce Commission did not take into account favorable earnings factors, and both the District Court and the Circuit Court of Appeals completely refused to recognize for its true worth the changed earning position which has been so markedly reflected in the earnings for the past two years.

Under the doctrine of the case of *Atchison, Topeka & Santa Fe Railway Company, et al.* v. *United States*, 284 U. S. 248, and *Central Kentucky Natural Gas Company* v. *Railroad Commission of Kentucky, et al.*, 290 U. S. 264, this Court should take judicial notice of economic changes such as are evidenced in the case of railroad earnings today, which earnings are a part of the record herein up to date of the filing of the record in this Court.

The Court below said that it was well satisfied that the evidence supported the finding of absence of value in the equity even though the evidence of the current earnings made since the plan was approved, were received and con-

sidered. It mentioned that there was a question of the court's power to base its decision upon 1941 statistics, which we feel has been settled by this Court in the two cases just mentioned. The three paragraphs in which the Circuit Court of Appeals states that there is no support for a finding of value in the preferred and common stock (Rec. 2311) reflect that Court's opinion that, although the Commission failed to make sufficient findings in accordance with the *Consolidated Rock Products Co.* case, still it could gloss over such failure so far as the equity holders were concerned. In the supplementary Per Curiam opinion issued January 12, 1942, the Court said that there had been a sufficiently specific finding as to the value of the equity, but it does not point to where this finding may be found. Certainly if the evidence might support a larger amount of securities, there would be room for some participation by the equity holders. Whatever findings were made by the Interstate Commerce Commission, they were wholly insufficient to enable the Court intelligently to pass upon the validity and legality of the treatment of the preferred and common stockholders.

II.

The Interstate Commerce Commission Failed to Perform Its Statutory Duty to Determine and Certify the Values of the Debtor's Properties in Accordance With Section 77(e).

The language of Section 77(e) provides in part:

> "If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, pres-

ent, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts."

Certainly this language is clear and unequivocal, and if it can be said that determination of value of property is ever necessary under Section 77, it must be held to be necessary in order to foreclose the stockholders of the Debtor and completely eliminate them from any participation in the plan of reorganization. Neither the Interstate Commerce Commission, the District Court, nor the Circuit Court of Appeals has discussed or considered the question of issuance of rights in the form of options or warrants to receive or subscribe for securities of the reorganized company, in order to give the stockholders participation in the event that in the future there might be some opportunity to participate in the earnings. Under the principles, first, of the *Boyd* case, second, of the *Los Angeles Lumber Co.* case, and third, of the *Consolidated Rock Products Co.* case, it is an absolute essential that a valuation be made of the Debtor's assets, which must be done in accordance with the above provisions of Section 77(e), and unless those assets are shown to have a value less than the aggregate of the debts, the stockholders can not be deprived of participation, in some form or other, in the plan of reorganization.

III.

The Plan of Reorganization as Approved Is Not Fair and Equitable, Does Not Afford Due Recognition to the Rights of the Preferred Stockholders, and Does Not Conform to the Requirements of the Law of the Land.

On July 31, 1940, the Protective Committee for Preferred Stockholders filed its objections to the plan of reorganization approved by the Interstate Commerce Commission and certified to the District Court (R. 1397). Briefly, these objections may be summarized as follows:

(1) The Commission erred in finding that the equities of the preferred stockholders have no value and that the holders of said stock should not participate in the allocation of new securities;

(2) The Commission erred in promulgating a plan of reorganization which failed to establish a valuation of all of the Debtor's assets for the purpose of determining whether or not said assets exceeded the Debtor's liabilities;

(3) The Commission erred in ignoring the fact that the value of the Debtor's properties established by the Commission under Section 19A of the Interstate Commerce Act was substantially in excess of the capitalization established by the Commission for the reorganized company;

(4) The Commission erred in its determination of earnings for a normal year for the reasons that (a) it does not appear that any consideration was given to the extensive maintenance program conducted by the Debtor out of earnings since the proceeding under Section 77 was instituted, as a result of which the true earning capacity of the Debtor has been understated; (b) calculations of future earnings have been based on the record during the most unfavorable period of the Debtor's estate as well as of industry generally; (c) no consideration has been given to the increased

earning capacity of the Debtor; (d) no consideration has been given to estimates of saving from coordinations and consolidations with other roads; (e) no consideration was given to the possibility of adjusting the increased labor costs incurred during the past decade, the entire burden of which is imposed upon the preferred and common stockholders under the Commission's plan;

(5) The Commission erred in establishing a capitalization for the reorganized company in an amount less than the invested capital in Debtor's properties;

(6) The Commission erred in establishing the effective date of the plan as January 1, 1939, rather than July 1, 1935, the nearest convenient date to the date of filing of the petition, and further erred in recommending that interest accrued since the date of filing of the petition should be allowed in full to such effective date of the plan on all issues of bonds and notes of the Debtor;

(7) The Commission erred in not having determined the value of the properties of the Debtor and in not having certified the same to the Court in its report of the plan as required by Section 77(e) of the Bankruptcy Act;

(8) The Commission erred in refusing to permit studies to be made of a plan based on the consolidation of the Debtor and the Chicago and North Western Railway Company;

(9) The Commission erred in approving a plan which is not fair and equitable, does not afford due recognition to the rights of each class of creditors and stockholders, is unfair to preferred stockholders, and does not conform to the requirements of the law of the land regarding participation of the various classes of creditors and stockholders in distribution of the securities of the new company, and is not in the public interest.

All of these objections to the plan were overruled to

the District Court and on appeal to the Circuit Court of Appeals were insisted upon both on brief and in oral argument. We deem each one of them of extreme importance and worthy of the consideration and determination by this Court. We do not wish at this time to make a detailed argument on these propositions and have therefore merely stated them, but in the event that this Court grants the petition for a writ of certiorari, they will be argued in our brief on the merits.

If the property of the preferred stockholders is to be taken completely from them as is done by the plan approved by the Commission and the District Court, and, insofar as the stockholders are concerned, approved by the Circuit Court of Appeals, it must be taken with due process of law. Certainly, the stockholders can not be said to have had such due process of law where there has been no actual finding as to value of Debtor's assets. We therefore maintain that the property of the stockholders, both preferred and common, has been taken in violation of the Fifth Amendment of the Constitution of the United States, both without due process of law and without just compensation.

In view of the fact that the reversal of the Circuit Court of Appeals below was entirely predicated upon the *Consolidated Rock Products Co.* case, *supra,* and the failure of the Interstate Commerce Commission to make the necessary "findings on issues vital to the question of values and equities as announced in said Consolidated Rock Products case" (R. 2315), it cannot be said to be either legal or equitable treatment of the stockholders to hold that insofar as they were concerned, sufficient findings were made. The Court itself said that the evidence might support a finding of a larger or a smaller amount but that the Commission was the fact-finding body so that the Court could not determine which amount should be accepted. If, as we contend, the evidence supports a larger amount of

capitalization, then certainly there is an equity for the preferred stockholders and the proceedings should be referred back to the Commission without any restrictions as to what they may or may not consider. To quote the Court on one of the pertinent holdings of the *Consolidated Rock Products Co.* case (R. 2309):

> "Findings must be made on all vital issues, controverted and uncontroverted, and must include values of properties separately considered and also of Debtor's property as a whole. Findings must cover values of liens to be surrendered and values of securities given in exchange. They should specifically cover the ultimate (not evidentiary facts) facts upon which the values are based. They must show that fixed interest charges are included and show that values are based on income-producing factors."

Conclusion.

The Preferred Stockholders Committee fully appreciates the length of time which has been consumed in these proceedings. Nevertheless the factor of time is far outweighed by the importance of complying with the provisions of Section 77, which require that a plan of reorganization conform to certain standards of legality and justice. Throughout the period of the proceedings the trustees operating the Debtor's properties have maintained it in splendid condition and the income has been so favorable as to warrant more than an expectation of a chance for the stockholders to participate, should they be allowed options or warrants under a fair plan of reorganization. We earnestly request that the issues raised by the elimination of the stockholders from such participation be scrutinized by this Court and that propositions of law be established which will enable the Commission definitely to know what standards should be followed not only in this case but in the case of all other railroad reorganiza-

tions under Section 77. For these reasons we believe the decree and opinion of the Circuit Court of Appeals below should be modified so as to provide for unhampered consideration by the Commission of new evidence and of the present evidence in the light of whatever principles may be enunciated by this Court, without any such restrictions as are suggested in the opinions of December 4, 1941, and January 12, 1942.

Respectfully submitted,

EDWARD R. JOHNSTON,
ALBERT K. ORSCHEL,
Attorneys for H. C. Orton, et al.,
Petitioners.

(36)

IN THE

Supreme Court of the United States

October Term, 1941

No. 881 [redacted] 55
(Circuit Court of Appeals No. 7615)

In the Matter of
CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, DEBTOR.

UNITED STATES TRUST COMPANY OF NEW YORK as Trustee of General Mortgage of Chicago, Milwaukee and St. Paul Railway Company dated May 1, 1889,
Petitioner,

et al.,

v.

GROUP OF INSTITUTIONAL INVESTORS, ETC., *et al.*,
Respondents.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit and Summary of Argument in Support Thereof.

GEORGE L. SHEARER,
M'CREADY SYKES,
Counsel for Petitioner.

WILSON & MCILVAINE, Chicago, Illinois;
STEWART & SHEARER, New York, N. Y.;
Attorneys for Petitioners.

March 23, 1942.

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Petitioner,

et al.,

v.

GROUP OF INSTITUTIONAL INVESTORS, etc., *et al.,*

Respondents.

To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

This petition is made by United States Trust Company of New York as trustee under the General Mortgage of the Chicago, Milwaukee and St. Paul Railway Company. Your petitioner respectfully prays that a writ of certiorari issue from this court to review the judgment or order of the

United States Circuit Court of Appeals for the Seventh Circuit, entered herein December 4, 1941, reversing the order of the District Court for the Northern District of Illinois which approved the Plan of Reorganization of the above named Debtor certified by the Interstate Commerce Commission as modified by such Commission, which order of the Circuit Court of Appeals further directed the District Court to set aside its order of approval and to remand the case to the Interstate Commerce Commission, and your petitioner prays that on such review the order of the Circuit Court of Appeals be modified as specified in this petition.

A petition for certiorari has been filed by the Group of Institutional Investors and Mutual Savings Bank Group. As we deem it important that the case be brought before this Court, we do not object to the petition of these Groups, believing as we do that the whole case should be reviewed by this court and that these issues, of grave import to the future of railway enterprise in this country, demand clear enunciation by this court.

Opinions below

This is a proceeding under Section 77 of the Bankruptcy Act for the reorganization of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company. Various plans for reorganization have been submitted and hearings held before the Interstate Commerce Commission. The report and order of the Commission approving a Plan of Reorganization were made February 12, 1940 (Transcript, pp. 1258-1283; 2153-2269; reported 239 I. C. C. 485). On June 4, 1940, a supplemental report and order was issued by the Commission modifying its previous Plan and as modified the Plan was approved and certified to the District Court (1284-1317; 1319-1347; reported 240 I. C. C. 257).

Sundry objections to the Plan were filed by various parties, including your petitioner, hearings on the objections were held in the District Court through several days in September, 1940, and evidence presented to the court in addition to the record before the Commission. On October 21, 1940, the District Court handed down its opinion approving the Plan (1857-1899; reported 36 Fed. Suppl. 193), and thereafter made findings of fact and conclusions of law and its order approving the Plan November 13, 1940 (1978-1992). An appeal therefrom was taken by several of the parties, including your petitioner, to the United States Circuit Court of Appeals for the Seventh Circuit, and after hearing such appeal that court reversed the order approving the Plan and by its order of December 4, 1941, reversed the District Court order and remanded the case to that court with directions to set aside that court's order of approval and to remand the case to the Interstate Commerce Commission for the making of findings, and if necessary, the taking of additional evidence, that additional findings might be made, as indicated in the opinion of the Circuit Court of Appeals filed herein (2322).

Some time after the making of this order of reversal application was made on behalf of stockholders for a "modification of opinion" (2324-2329) and a supplemental order was thereafter made by the United States Circuit Court of Appeals January 12, 1942 (2334-2335) in which it was declared:

> "Now, to make our position entirely clear, we add this memorandum and hold that the finding of the I. C. C. as to absence of value of old common and preferred stock, is specific, definite and certain, and fully meets the rule which requires finding on values of assets.
>
> Second, we meant to hold, and do hold, that the evidence supports this finding, that there is no value to either the common or preferred stock of debtor. It follows that this branch of the case, the value of the equity of the debtor, evidenced by the common and

preferred stock, is closed, and the I. C. C. need not further investigate or make further finding on this issue unless it is convinced that changed conditions in railroad earnings warrant it. In other words, the I. C. C. has jurisdiction of the matter and may, although it is not required to do so, re-examine the evidence, or receive additional evidence, if in its judgment, justice to the parties requires it.

The motion to amend the opinion is DENIED."

Summary of Matters Involved

THE PROPERTY

Your petitioner's General Mortgage for $150,000,000 is the underlying mortgage placed in 1889 on what was then the entire system of the Chicago, Milwaukee and St. Paul Railway Company and is now the main line of that company's successor, the present Debtor. Many years after this mortgage was made the mortgagor company, the old Chicago, Milwaukee & St. Paul, caused to be built and then acquired the so-called western extension, a new railroad running from the Missouri River terminus of the old Milwaukee in Mobridge to the Pacific coast. This added enterprise is for convenience referred to as the lines west. Still later the old Milwaukee acquired substantially all the capital stock of the Chicago, Terre Haute and Southeastern Railroad Company, hereinafter referred to as the Terre Haute, and made a lease whereby it acquired the use of that road, agreeing to pay as rental therefor the interest on the road's bonds and a fixed sum of $12,000 a year for routine organization expenses, and to pay the principal of the bonds on maturity. Certain other additions had been made to the Milwaukee system since our mortgage was executed, but those above mentioned are the principal additions here involved and present certain of the most substantial and important questions involved in this litigation.

As for the lines west, the Commission specifically reported (1307):

> "We are satisfied that on any reasonable basis of allocation between the lines west and the other parts of the system, the lines west cannot be expected to earn any sum for the payment of interest."

Our underlying General Mortgage has at all times been and now is fully secured by the mortgaged property and its earnings. Of the $138,788,000 of bonds issued under our mortgage and outstanding in the hands of the public there is, including accrued interest unpaid, a total claim of $156,368,193; the remaining $11,212,000 principal of those issued are pledged with the Reconstruction Finance Corporation (2166). Partial payments have been made on account of bond interest accruing since the initiation of this proceeding (*ib.*). These bonds are secured by a first lien on the main railroad system. It is reported by the Commission (2167):

> "The properties subject to the first lien of the general mortgage included 6,044 miles of road wholly owned, lying east of the Missouri River, 11.3 miles of road jointly owned, various trackage rights, 1,030 locomotives, 24,690 freight cars, 885 passenger cars, and 2,013 units of work equipment not subject to the lien of equipment trusts, 7,000 shares of the capital stock of the Chicago Union Station Company, and certain cash. Subject to the lien of equipment obligations totalling $25,031,319, the general mortgage was also secured by a first lien on 119 locomotives, 32,441 freight cars, 79 passenger cars, and 26 units of work equipment. It appears that no equipment deficiencies have been incurred under this mortgage."

The depreciated book value merely of this equipment owned outright, and of the equity in that owned subject to equipment liens, was, under date of June 30, 1935, approximately $49,000,000 (I. C. C. Exs. 74 and 114, not printed).

For all practical purposes the Fifty-year Five per cent mortgage, referred to for convenience as the Fifty-year

Mortgage, is a first lien on the lines west and a second lien on our main line. It is at present subject to a small issue of First and Refunding Mortgage bonds, but none of these are in the hands of the public and under the Plan they are to be retired and their first lien may be disregarded. One of the fundamental facts of the situation is that the lines west, for almost the whole time since the consummation of the ill-advised enterprise of their construction, have been deficit lines. As the Commission found (1307):

> "We are satisfied that on any reasonable basis of allocation between the lines west and the other parts of the system, the lines west cannot be expected to earn any sum for the payment of interest. In years when the system earnings approach $10,000,000, some interest is apparently earned for the 50-year mortgage bonds under the present capital structure, but this reflects system operation and does not demonstrate any earning power for the western lines."

The Fifty-year Mortgage, in addition to being practically a first lien on the lines west and a second lien on our line, was a lien immediately junior to that of the First and Refunding Mortgage on certain collateral pledged under the latter. At the moment such lien is subject to the First and Refunding Mortgage, but as stated above that mortgage is to be cancelled, so that the Fifty-year Mortgage would be the next lien on such collateral. As this is to be brought about by giving the present holders of the First and Refunding Mortgage security 100 per cent of their claim in new First Mortgage fixed interest bonds, thus reducing the amount of such bonds available for allocation to the bondholders under our underlying mortgage, a question is presented as to whether or not our bondholders should be subrogated to the rights of the First and Refunding Mortgage. For our position on this question we refer to the petition for certiorari and supporting brief of the Group of General Mortgage bondholders consisting of Princeton University and others.

Terre Haute

As for the Terre Haute stock and bonds and lease, the Commission found that the present lease was burdensome and should be rejected by the trustees. The Commission's Plan, however, did not provide, as we contended that it should provide, merely for the rejection of the lease, leaving the Terre Haute interests and the reorganized road free to negotiate such traffic agreement as might be found proper in the event that the reorganized road should wish to continue the use of the Terre Haute. It engrafted on the Plan a proposed new arrangement to be offered the Terre Haute interests, with a provision that if substantially all of them did not accept such modified Plan, the lease should in that event, and in that event only, be terminated. Among the objectionable features in the present lease was the Milwaukee's assumption of the obligation of payment of principal and interest of the Terre Haute bonds, bonds exceeding in amount the $20,680,114 value of the Terre Haute properties, awarding to the holders of the securities of the dubious Terre Haute enterprise a largess far exceeding, in its liberal percentage of compensation, the attenuated recompense offered the holders of our well secured underlying bonds secured by property valued at $359,115,599 (2215).

Probable prospective earnings

For its estimate of the system's earnings before fixed charges, the "probable prospective earnings" to be used in providing for fixed charges under Sec. 77 of the Bankruptcy Act, sub. (b), the Commission used two five-year averages, one 1931-35, showing $7,852,798 and the other 1932-36 showing $7,988,191. One at 116 per cent and the other at 118 per cent coverage would give the figures used by the Commission as it points out in its report, and as the two amounts are so close and are both stated in

the report, the Commission's finding of prospective earnings is in effect the mean between the two, or $7,920,425 (2219). These figures are of course of several years ago, ending with 1936 at the latest. On any rehearing on which findings are to be made, both the court and the Commission will assuredly have to consider the figures nearer to date. The trustees' evidence at the court hearing showed net earnings before fixed charges for 1940 (the last six months being estimated) of $14,079,381 (Debtor's Ex. 6 in District Court). Current earnings are at a very much higher level than this, which itself is much higher than the available earnings in either of the five-year periods mentioned. As it stands, nothing since 1936 is reflected in the Plan.

The "Pieces East"

There are a few pieces of line integrated with the General Mortgage lines, acquired since the execution of that mortgage, which are referred to as the "pieces east." There is a controversy, left undetermined both by the Commission and by the courts below, as to whether they are covered by the after-acquired property clause of the General Mortgage and thus subject to its first lien, or on the other hand do not fall within it and are therefore subject to the first lien of the First and Refunding Mortgage and to the second lien of the Fifty-year Mortgage (2252).

Treatment of General Mortgage Bonds under the Plan

Under the Plan as modified (1317) there was to be a First Mortgage on the entire system, including not only the main railway system now subject to our underlying mortgage but also the unremunerative lines acquired many years after our mortgage was made, specifically the so-called lines west from the Missouri River to the Pacific coast. New First Mortgage bonds were to be pres-

ently issued for distribution among various classes of security-holders to the amount of $53,923,171, in addition to which the new company was to assume the obligations of the $21,929,000 of Terre Haute bonds. The holders of the present General Mortgage bonds were to receive $39,092,049 of new First Mortgage bonds, being 25 per cent in par value of their secured claim, an amount based on a capitalization of probable minimum future earnings which excludes $2,500,000 per year of such earnings from capitalization and gives us no fixed-interest or First Mortgage bonds based on that portion of the earnings, but diverts that portion to an Additions and Betterments fund for future *capital* requirements year by year. The Plan also provided for new contingent-interest second mortgage bonds of two series, of which the present General Mortgage bondholders were to have Series A bonds to the extent of 35 per cent of their secured claim, or $54,728,867, and $31,273,638 of Series B bonds, this being 20 per cent of their secured claim. As between these two series the Series A bonds were to be prior in charge as to interest only. Along with the issue to us of $31,273,638 of Series B bonds, $19,084,621 of the same issue were to go to the present holders of the Fifty-year Mortgage 5 per cent bonds now secured by the lines west, on which our mortgage is not a lien and whose only lien on our mortgaged lines is admittedly a subordinate one. This would leave 20 per cent of the General Mortgage claim still to be provided for, and this was attempted to be accomplished by alloting to their holders such 20 per cent in new preferred stock. The new preferred stock thus allotted to them amounted to $31,273,638 (at $100 par), but the greater part, or $76,338,481 of the $111,347,846, of new preferred stock went to the Fifty-year Mortgage bonds. To pay the dividend on this preferred stock would require, under the present tax law, earnings of between $40,000,000 and $50,000,000 per year. The road has never, even in the pre-depression days, earned as much as $33,000,000 per

year, so that this allotment of preferred stock is hardly more than a gesture. Thus the only new First Mortgage bonds for the General Mortgage bondholders would be in the amount of 25 per cent of their secured claim, a total of $39,092,049 among the $53,923,171 to be presently allotted, or among $69,273,171 of the fixed-interest portion of the bonds if we include the $15,350,000 fixed-interest portion of the Terre Haute bonds whose obligation is to be assumed.

No provision for new evidence

As the present order stands, it is left to the discretion of the Commission whether it will take additional evidence. We should not have supposed that either an administrative or judicial inquiry, undertaken to lay the foundations of a plan of reorganization affecting among other things the rights of secured creditors running into hundreds of millions of dollars, could be carried through without enlightenment as to the present conditions and earnings of the property and in disregard of evidence of anything more recent than four years ago. The statute requires due consideration of past, present and prospective earnings.

The foregoing statement has been made as concise as is consistent with a presentation of enough of the background to make possible an intelligent understanding of the issues presented. A complete tabular summary of the Plan is shown on page 5 (wide-page insert) of the petition for certiorari presented by the Institutional Investors and Mutual Savings Bank Groups.

This is the Plan of Reorganization reported by the Commission and, with slight modification or corrections, approved by the District Court, and now apparently approved in general plan and principle by the Circuit Court

of Appeals, the reversal being for the purpose of making necessary findings and the Plan itself being in general commended. Our contention is that such a Plan does not meet the requirements imposed by law for a plan of reorganization; that it is unfair and inequitable and not in conformity with the law of the land and unlawfully deprives our bondholders of their property in violation of law and of the Fifth Amendment to the constitution of the United States. Its manifest departures from the standards imperatively laid down by Sec. 77 ignore a mandate which but recognizes and incorporates in the Bankruptcy Act certain fundamental principles required by the constitution and the law of the land. On the case being sent back for the restatement and reformulation of a plan, it is in the interest of justice, and in the public interest, that this court declare and so far as needful formulate those inherent and fundamental requirements that must inexorably be recognized and applied by the Commission. Otherwise this reorganization will be protracted beyond reasonable limits and the present errors and unjustifiable subversion of recognized principles be repeated and require probably several years for their judicial correction through the slow process of future appeals.

The "questions presented" are formulated in a later part of this petition, but to make a complete presentation of the matters involved their nature is stated in general as follows:

1. Our bonds are entitled to the protection of the established principle of absolute priority

It being shown that our mortgage is the underlying first lien on almost the whole of the remunerative portion of the Milwaukee system, under the principle of absolute priority, as declared in *Northern Pacific R. R. Co.* v. *Boyd,* (228 U. S. 482) and reaffirmed as applicable under the bankruptcy statutes in *Case* v. *Los Angeles Lumber*

Co., (308 U. S. 106) and *Consolidated Rock Products Co.* v. *Du Bois*, (312 U. S. 540), our bondholders are entitled to the preservation of their prior lien. It is recognized that in the public interest the interest charges on new mortgage bonds given in reorganization to old bondholders may as to a portion thereof sometimes be made contingent, so that bankruptcy will not be a necessary result of the road's inability to earn its entire mortgage interest, and it is recognized that in drawing the line between fixed interest and contingent interest under any new mortgage a reasonably safe leeway or coverage must be provided. Using the Commission's finding above referred to of minimum prospective earnings of $7,920,425 per year, it is contended that under Section 77 of the Bankruptcy Act it is imperatively required that after deducting from this amount a fair and reasonable portion thereof to represent coverage and whatever may be required for other fixed charges ranking ahead of us, then for our underlying mortgage, and any other secured claims on a parity with it, the Plan should capitalize the remainder of these prospective minimum earnings in the form of a first lien on the mortgaged property, so that the secured creditors should receive new first lien fixed interest securities representing the capitalization of such remaining minimum prospective earnings up to the amount of their present secured interest charge. In fixing its capitalization the Commission has made deductions to allow for a coverage of 116 per cent, as to which there is no controversy, and has made further deductions representing equipment obligations and certain other obligations in respect to leased lines. These include the Terre Haute lines. Their treatment is a subject of separate contention on our part and may for the moment be disregarded.

2. Additions and betterments fund

We have objected to the deduction made at this point by the Commission of a mandatory Additions and Betterments fund, fixed by the Commission at $2,500,000 per year. The purpose of this fund, as the name indicates, is to provide for *capital* expenditures. We contend, as a matter of law, that the prospective minimum net earnings available for fixed charges must under the principle of absolute priority be made available to our bondholders; that to divert them to capital expenditure for the benefit of the equity would be to violate our legal and constitutional rights. If in the public interest it were deemed that such expenditures must be made and that there were no source other than earnings from which to make them, then if earnings contractually available for our interest were resorted to this would in effect be a forced loan and we should be entitled to contingent interest bonds, fully cumulative, preserving our right to have such forced loan made good upon there being subsequent net earnings available therefor.

The practical effect of interposing this $2,500,000 mandatory Additions and Betterments fund among the fixed charges, where we contend it has no place, is of course to diminish to that extent the income available for interest on the new first mortgage bonds; in other words to reduce by the capitalized value of such $2,500,000 the amount of bonds available for the present holders of underlying mortgage bonds. Capitalized at the allowed rate of 4 per cent (as to which rate there is no question raised by anyone) this means that our bonds are to receive $62,500,000 less first mortgage bonds than they would receive if the Additions and Betterments fund were not injected into a place among the fixed charges; so that instead of receiving new first mortgage fixed interest bonds for approximately 66½ per cent of our bondholders' secured claim they are to have but 25 per cent thereof. This raises, of course, as we have

just pointed out, the fundamental question of law whether under the established principle of absolute priority it is permissible to withdraw from the income pledged to the underlying mortgage bondholders this large sum desired for capital Additions and Betterments; or, even assuming that in the public interest this may be done, whether if so done it may be properly treated as anything other than a forced loan from the underlying mortgage bondholders which should be repaid should further earnings supply the means. The latter object would be accomplished, so far as it may be, by giving the underlying mortgage bondholders, for an amount equal to to the fair capitalization of the portion of interest so withheld, contingent interest bonds with interest fully cumulative. Under the Plan, however, they by no means receive full cumulative contingent interest bonds for the portion of their debt not represented by new fixed interest bonds. Under the succeeding categories they are to receive 55 per cent of their debt in contingent interest bonds, but these are not fully cumulative, the accumulation being limited to three years, and for 20 per cent of their holdings they are to receive the wholly illusory distribution of new preferred stock, represented by certificates bearing it is true a figured inscription reading "$100" each but representing in fact a share in earnings which under the present tax structure would be wholly absorbed by taxation and would never reach the stockholders.

3. Dilution of our mortgage security

Thus the Plan offers our bondholders new fixed interest first mortgage bonds to the extent of but 25 per cent of the face value of their secured claim; for the next 35 per cent thereof they are to have contingent interest bonds Series A, and for 20 per cent contingent interest bonds Series B. The difference between these two series is that Series A has priority as to income; as to principal there is no pri-

ority as between the two series. But in the allotment of Series B bonds our bondholders do not have the entire issue of those bonds, as they presumptively should have to conform to the principle of absolute priority, for they share that issue with holders of the present Fifty-year Mortgage bonds, a junior issue. We recognize that in the application of the principle of absolute priority it is sometimes practically necessary that holders of present prior liens should receive new securities of an issue some of which are allotted to holders of present junior liens. This was expressly recognized in *Case* v. *Los Angeles Lumber Co.* (308 U. S. 106) and in *Consolidated Rock Products Co.* v. *Du Bois* (312 U. S. 540); but in the former case it was pointed out that such dilution or intrusion of junior lienors to share in securities allotted to prior lien creditors should represent some value contributed by them to the enterprise, and in the latter that such a dilution must be based on specific findings of values of respective property contributions, and compensation must be made for the lienor's "full bundle of rights". Nothing of the sort was shown here; the Fifty-year Mortgage district is, as we have shown by reference to the finding of the Commission, a deficit line, nor is there anywhere in the record any finding of value contributed by its mortgaged property. We therefore contend that the award to the Fifty-year Mortgage bondholders of any portion of the contingent interest bonds unlawfully dilutes our bondholders' security and gives them less than the absolute priority to which under the decisions of this court they are entitled.

4. The plan imposes on bondholders now secured by an underlying mortgage the burden of a new mortgage made by a corporation obliged by its charter to operate a deficit line, thus unlawfully impairing the earnings pledged for the payment of our interest

Under the traditional obligations of a mortgage, which in general are in principle recognized and preserved in reorganization, a mortgagee is entitled to the security of his lien, and the principle of absolute priority must be maintained. This means that normally he should have in the reorganized company a lien upon the same property, and the ultimate right to make the earnings of that property available for his debt, as that on which he holds his mortgage. Our mortgaged property was the definitely described established line of the Chicago, Milwaukee and St. Paul Railway Company; a property of high value and earning power and earning even in the depression more than enough to pay our interest. The Plan offers our bondholders the mortgage of a new corporation which is to own, and whose duty it would be to operate, in addition to the General Mortgage lines, a line of railway forming no part of our original mortgaged property and acquired many years after our mortgage was given. To force us to take the bonds of a corporation thus obliged to carry in perpetuity this old man of the sea is to decree that the payment of the annual deficit of such a new enterprise be included among the operating expenses of the railroad whose new mortgage we have to take. Such an intrusion into the income pledged for the payment of our interest would in the case of an ordinary mortgage not be tolerated by a court of equity nor might it ordinarily be lawfully imposed by the law-making body. To be sure, this is the case of a railway, but it can hardly be any supposed public interest that is invoked for the sake of "simplifying the mortgage structure" and to carry out a policy of reducing the number of railroad corporations in the country. There is nothing shown in the present record indicating that it would be

impracticable to have separate corporate organizations co-extensive with the wholly separate and distinct enterprises represented by the original Chicago, Milwaukee and St. Paul Railway and by the western lines organized and built in subsequent years. Recognition in the corporate organization of the distinct identities of two enterprises would not mean that the western lines were to be summarily cast adrift. Doubtless operation would be continued for a substantial period under a lease or operating agreement with the original company. Indeed, the Commission has not found that such operation could not be continued, nor that the existing lien of our mortgage could not be preserved without impairing our right to resort to the net income of our own mortgaged property free from liability to diversion to pay operating deficits on another line. The Commision simply suggests that such a mortgage structure would be too cumbersome, but we contend that the integrity of our mortgage lien may not be lawfully impaired in such an easy way or so summarily dismissed. Indeed, the Fifty-year Mortgage interests themselves do not question the practicability or advisability of separate organizations for the two roads. They have a second mortgage on our lines, to whose benefit they are entitled. We have no lien on their lines and it is contrary to law that such a juggling and distortion of liens be willy-nilly imposed upon us with the burden of carrying in perpetuity the operating deficit of a line not in existence or conceived of when our mortgage was given.

With the order made by the Circuit Court of Appeals so far as it reverses the order approving the Plan we have of course no disagreement, for the Plan propounded by the Commission and approved by the District Court could not, in respect to the matters immediately above presented, have been approved by the appellate court without violating the legal and constitutional protection afforded secured creditors by Section 77 of the Bankruptcy Act. But the

court's implied approval of the Plan, with its cryptic comment that "the fact situation permits of a Plan such as the Commission formulated and approved" (2312), sets on the Plan an implied approval which, we submit, is not only admittedly without the supporting premise of informed judgment but violates the fundamental principles of the law of the land carefully reiterated in the bankruptcy act itself as a precaution against confiscation such as has been attempted by this Plan.

We contend that the Court of Appeals should have definitely and explicitly sustained our contentions and granted our demand that these objectionable and illegal features be eliminated from the Plan. On the contrary, in principle and by obvious implication it has tolerated those very features and has in practical effect suggested that the Commission embody them in a new plan. The conclusive and inescapable basis of our objection is found explicit in the present record. It rests on facts found and reported by the Commission.

Basis of jurisdiction

The basis of jurisdiction of this court is Section 240 (a) of the Judicial Code (28 USCA Sec. 347) providing that in any case in a Circuit Court of Appeals it shall be competent for the Supreme Court of the United States to require by certiorari that the case be certified to it for determination.

Questions presented

1. Whether, on a railway reorganization under Sec. 77 of the Bankruptcy Act, an underlying mortgage fully secured by property the value of which is found to be far in excess of the amount of the mortgage, and whose interest has been and is being more than earned, may lawfully be discharged by the issue to its bondholders of reorganization securities of the following character:

a. First mortgage fixed interest bonds to the extent of 25 per cent of the face value of the old bonds and unpaid interest, secured by the mortgage of a railway corporation obliged by its charter to operate an entire railway system including not only the original mortgaged line but an extensive addition thereto never covered by the underlying mortgage, of which addition it is found that no earning capacity exists and whose operation at a loss would be a serious and permanent burden on the reorganized company.

b. Contingent interest second mortgage bonds of such enlarged railway corporation to the extent of 55 per cent of the face value of the old bonds and unpaid interest, such contingent interest bonds being part of an issue which includes a substantial amount of bonds given to the holders of bonds under a mortgage junior and subordinate, so far as the main line is concerned, to the underlying mortgage first mentioned, where no compensation is awarded the holders of the underlying bonds for the dilution of their existing lien by the inclusion of such new bonds issued to holders of such junior bonds; and

c. Preferred stock in such enlarged railway corporation for the remaining 20 per cent of the face value of the underlying bonds and unpaid interest; such amount of preferred stock representing but a small portion of the entire issue, the greater part of such issue being given to holders of securities junior to that of the underling mortgage, and no compensation being awarded the holders of the underlying bonds for such dilution of their existing lien.

2. On a railway reorganization under Section 77 of the Bankruptcy Act, when the minimum prospective earnings available for fixed charges shall have been deter-

mined, whether on capitalizing the same for reorganization securities there may be deducted therefrom a substantial proportion thereof to provide an annual fund for additions and betterments of a capital nature and the amount of fixed interest mortgage bonds to be awarded the underlying mortgage bondholders correspondingly reduced.

3. In the event that after the lapse of more than four years since the closing of evidence by the Interstate Commerce Commission in a reorganization proceeding under Section 77 of the Bankruptcy Act, the order of the District Court approving the Plan is reversed and the case remanded to the Commission with directions to make necessary findings, any of the parties to the proceeding may lawfully be deprived of their right to present to the Commission evidence in respect to the earnings and value of the mortgaged property subsequent to the period available when the former Plan was prepared, and whether the reception of such evidence may be lawfully left to the discretion or determination of the Commission.

Reasons relied on for the allowance of the writ

1. Practical need of present determination by court of last resort

It would be unfortunate to send the case back to the Interstate Commerce Commission, as the order of the Circuit Court of Appeals provides, with grave questions of law left so largely hanging in the air; thence to pass again through the slow process of the Commission, the District Court and the Circuit Court of Appeals and at that late date only to bring the case to this court, should this court so decree, for the belated determination of the fundamental questions basic to the making of a plan which will conform to law. The determination of those prin-

ciples by the court of last resort should rather be available as the norm or standard of reference in the final formulation of the plan. It is to the public interest that we have the judgment of this court on the fundamental questions involved. In a judgment now rendered by this court finality will be implicit.

2. THE PRINCIPLE OF ABSOLUTE PRIORITY OF LIEN. DILUTION OF MORTGAGE LIENS WITHOUT COMPENSATION

The Circuit Court of Appeals has decided in this case several important questions of federal law, herein specified, in a way palpably in conflict with applicable decisions of this court. The principle of absolute priority declared in *Northern Pacific R. R. Co.* v. *Boyd* (228 U. S. 482) definitely establishes that existing priorities may not be subverted in reorganization. This principle, applied in the *Boyd* case to an equity receivership, has by more recent decisions of this court in *Case* v. *Los Angeles Lumber Co.* (308 U. S. 106) and *Consolidated Rock Products Co.* v. *Du Bois* (312 U. S. 540) been declared equally applicable to reorganizations under the Bankruptcy Act. Under these decisions of this court it is the law of the land that holders of underlying bonds are entitled to the preservation, on reorganizations in bankruptcy, of their priority of lien or to the award of full compensation where it may be impracticable to preserve such lien in its existing form. The Circuit Court of Appeals has of course not in terms declared that the principle of absolute priority is not applicable to railway reorganizations, but the effect of its present decision is to put the General Mortgage bondholders of the Milwaukee outside the protection of that principle. The Series A and B of new income bonds, of which Series B are to be shared with junior lienors, and a minority block of preferred stock, are the new securities offered them for 75 per cent of their claim under their present underlying bonds. These, along with the new first

mortgage bonds for the other 25 per cent of their claim, make the whole of what they are to receive for their underlying lien. As this is all they get, it is mathematically impossible that compensation can be found in the Plan for the sacrifice of their first lien position.

Thus to scale down the rights represented by existing priority of lien, distributing at the same time other securities among junior lienors while leaving the underlying bondholders' sacrifice of lien uncompensated, is to fly in the face of the principle of absolute priority so repeatedly and emphatically pronounced by this court. As this court said in *Consolidated Rock Products Co.* v. *Du Bois* (312 U. S. 510, 528-9):

> "Thus it is plain that while creditors may be given inferior grades of securities, their 'superior rights' must be recognized. Clearly, those prior rights are not recognized, in cases where stockholders are participating in the plan, if creditors are given only a face amount of inferior securities equal to the face amount of their claims. They must receive, in addition, compensation for the senior rights which they are to surrender. If they receive less than that full compensatory treatment, some of their property rights will be appropriated for the benefit of stockholders without compensation. That is not permissible. The plan then comes within judicial denunciation because it does not recognize the creditors' 'equitable right to be preferred to stockholders against the full value of all property belonging to the debtor corporation'. Kansas City Terminal Ry. Co. *v.* Central Union Trust Co., supra, 271 U. S. page 454, 46 S. Ct., page 551, 70 L. Ed. 1028."

The junior lienors with which the General Mortgage bondholders are thus forced to share are the bondholders under the Fifty-Year mortgage, whose primary lien is on the so-called lines west, the unprofitable Pacific extension whose construction and continued deficits are primarily responsible for the road finding itself today in a bank-

ruptcy court. Of this ill-advised enterprise the Commission has found that "on any reasonable allocation between the lines west and the other parts of the system the lines west cannot be expected to earn any sum for the payment of interest" (1307-8). The Fifty-Year mortgage is a junior lien on the main line on which our mortgage is an underlying lien. Its bondholders are entitled to a first lien on their Pacific extension and a lien on our main line subject to our first lien thereon. Their rights may not be exalted to a right to cut down our prior lien unless full compensation be afforded us, and of such compensation there is no suggestion. Therefore the order of the Circuit Court of Appeals should have corrected this manifest violation of the mandate imposed by the statute.

This presents a question of law of the utmost general importance in railway reorganization. We have the not uncommon situation of a remunerative main line forced into a bankruptcy court through the ill fortunes of an enterprise taken on long after the underlying bonds had been put out. The new securities to be allotted the bondholders of such unprofitable extension may not lawfully be of the same rank as those given the underlying bondholders having a prior lien unless full compensation be made to the latter for such impairment by dilution of their lien. The attempt to accomplish such dilution renders the present Plan confiscatory and subjects it to the condemnation of the *Los Angeles Lumber Company* and *Consolidated Rock Products* cases. Its importance is evidenced by the number of pending reorganizations in which a similar situation is presented. If it be true that the nature of a railway investment is so profoundly different from that of a mortgage generally, as developed and established through a long history of judicial exposition, that considerations of public interest justify such a subversion of its lien and subjection to the risks of new enterprises not owned or conceived of when the mortgage was given, then

the investing public should be made authoritatively aware of the altered and novel place of their security before the law. These issues are here concretely presented. They should be decided by the court of last resort.

3. Additions and betterments fund

The Circuit Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this court. It categorically approves in principle the Plan's device of an "Additions and Betterments Fund," a fund for capital expenditures to be withdrawn from the income, its amount fixed mandatorily at $2,500,000 per year, thus reducing the permissible fixed interest capitalization by the capitalized value of $2,500,000. At the adopted interest rate of 4 per cent this means $62,500,000. The result is that the holders of the underlying bonds find allotted them $62,500,000 less of fixed interest bonds than they would have received but for the interposition of this $2,500,000 Additions and Betterments Fund.

Capital funds of this kind, appropriated out of the net income already pledged to mortgage bondholders for the payment of their interest, have been coming much into fashion among current proposed plans of reorganization, but have not yet been considered by this court. Of course the effect of such a Plan is to make use of net income to enrich and fortify the physical assets of the enterprise while the bondholders must, to that extent, go without their fixed interest, trusting to find it, if the earnings continue high enough, somewhere farther down the line. Additions and betterments are not a new category in railway financing. They inherently are and always have been considered a capital charge, quite distinct from maintenance, and they have always appeared in the capital account. The principle or guiding concept of the present

fashion is precisely the same as that which would be applied if a farmer who had mortgaged his farm, specifically pledging its net income, were to announce that his farm would be improved by the construction of a silo and that he had decided to use the net income of the farm to build a silo instead of to pay the mortgage interest, and such a modification of the mortgage were to receive judicial sanction.

Whether such a diversion of net income may lawfully be mandatorily imposed on a railroad with the immediate, simultaneous and necessary consequence of cutting down its fixed interest mortgage obligations is to say the least a novel question. Certainly the principle has never been announced by this court, and it presents a question that emphatically ought to be settled by this court. The decision below asserts that such diversion of income and subversion *pro tanto* of mortgage lien is quite legal. Indeed the court declares (2313) that "In fact we find few things in the Plan which appeal stronger than this provision," but this is all it has to say about its legality. Of that there is not a word of discussion or exposition.

The problem of providing for additions and betterments without unlawful destruction of liens whose right to the maintenance of their absolute priority has received the repeated sanction of this court is of course a difficult one. We are confronted by the inescapable fact that a railroad must have additions and betterments and that the financial sources of outside capital traditionally available therefor are not so plentiful as they have been. The Plan, however, provides for an open first mortgage, the first series of which is of such small amount that it seems unduly pessimistic to regard the sale of bonds under other series as wholly excluded. The diversion of pledged income to capital additions and betterments runs counter to the respective decisions of this court as cited above. If on some theory to be now established this may lawfully be

built into a plan of reorganization at all, it can be nothing other than a forced loan. If that could be done, the displaced bondholders must receive at the very least contingent interest bonds whose interest, if thereafter earned, may repay the loan thus forced from them. This vital question of additions and betterments to enrich the equity at the expense of secured bondholders is most emphatically one on which this court should at the earliest opportunity, afforded by a concrete case such as the present, announce the legal principle to be observed in such cases.

For many years under the Commission's accounting rules it has been necessary to charge additions and betterments to capital account and to finance them either from earnings or by the issue of new securities. In no event has it been possible to resort to what is proposed here—the illegal device of taking income already pledged to the payment of mortgage interest and diverting it to the cost of capital improvements. Certainly on this whole question of provision for additions and betterments it is of the highest public interest that this court state clearly and unequivocally the principle applicable to such a situation. Otherwise the prevalent intrusions into the income account of additions and betterments funds will cast an ominous shadow on the whole field of future railway investment. In short, this issue presents an important question of law which has not been, but should be, settled by this court.

4. Forcing a reorganized road to carry an unremunerative enterprise

Another question which should be settled by this court is whether the holders of underlying railway mortgage bonds may lawfully be compelled to accept therefor mortgage bonds of a new company owning and by its charter bound to operate a railway line altogether separate and distinct from the line originally mortgaged, the two lines being united only at their point of meeting, where the new line is found by the Commission to be without earning capacity. The facts showing the lack of earning capacity in the lines west were specifically found and reported by the Commission. We contend that to force on our bondholders in perpetuity the burden of paying the deficit of a road not within their mortgage is illegal. What was and is obviously called for is a separate first mortgage on the lines west, giving their present bondholders a second mortgage on our main line, corresponding with their present second lien, and a first lien on any assets on which they now have a first lien, subject to whatever adjustments may be equitably demanded by way of subrogation or marshaling.

Similar situations have arisen before, where a railway has been condemned to disaster by the ill-advised taking on of new construction not warranted by the country's needs. So long as the united enterprises as a whole could pay its way, no judicial relief was necessary. But when the point was reached where the deficit adjunct was carrying the whole enterprise to insolvency, the senior mortgagee might rely on the security given by his mortgage lien. It was that fundamental right that made it possible to finance railways by the sale of bonds. The Circuit Court of Appeals' acquiescence in the principle of the present Plan as fair and lawful presents an issue of the greatest import to all who would invest in railway bonds. It

is of the utmost interest that the question be settled by the court of last resort. It is hard to imagine a case more clearly within the range of the established policy of this court of giving ear and rendering judgment when such grave issues stand waiting the word of finality.

5. On a rehearing by the Commission the right of all interests to be heard and to present evidence should be preserved

We think that the provision in the order sought to be reviewed whereby it is left to the discretion of the Commission whether or not it will receive further evidence presents an important question of federal law that has not been and should be settled by this court. To meet the plain requirements of the law any plan must be cleared of the legal defects which vitiate the present Plan. What is imperatively needed at this point is a clear statement by this court of the fundamental principles necessary to be claimed. As the present order reads, the Commission would find, in the language of the opinion below, that the case has been remanded "for the making of findings and, *if necessary,* the taking of additional evidence" (2317; italics ours). We can hardly consider that the Commission would seriously attempt to make findings leading to a reorganization having the enduring consequences here involved, without making available to itself the history and actual fortunes of the road since the time when its present record closed some four years ago. Too much water has flowed over the dam since that time to make an estimate of earning capacity based on data ending with 1937 the proper basis of a plan made in 1942. What might be considered adequate then would not be so now. The statute itself imposes the mandate that due consideration be given to "*present* earnings." Yet as the order stands the Commission may apparently receive or not re-

ceive new evidence, according as it may or may not "deem it necessary." Indeed, in a supplemental order issued, to use the language of the court, to make its position clear, the Circuit Court declares that the new inquiry need not extend to the value of the equity of the Debtor evidenced by the common and preferred stock, and that the Commission may, "although it is not required to do so, reexamine the evidence, or receive additional evidence, if in its judgment, justice to the parties requires it" (2335). We believe that it would be setting an unfortunate precedent for a railway reorganization to be sent back to the Commission to make findings with a suggestion of possible judicial approval that the door may at the Commission's discretion be closed to evidence of the operation and history of the road brought fairly down to date. The statute requires a consideration of past, present and prospective earnings, and if the Commission were to attempt to make new findings based only on the earnings reflected in the present report and Plan, it would be wholly excluding from consideration present earnings and indeed a substantial part of past earnings. In view of the approaching consummation of this and other reorganizations of major railway systems, such an important question running to the very heart of administrative and judicial investigation should be settled by this court.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari issue from this court to review the judgment or order of the United States Circuit Court of Appeals for the Seventh Circuit, entered herein December 4, 1941, reversing the order of the District Court for the Northern District of Illinois which approved the Plan of Reorganization of the above named Debtor certified by the Interstate Commerce Commission, as modified by such Commission, which order of the Circuit Court of Appeals further directed the District Court to set aside its order

of approval and to remand the case to the Interstate Commerce Commission, and your petitioner prays that on such review the order of the Circuit Court of Appeals be modified as specified in this petition.

March 23, 1942.

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(37)

IN THE

Supreme Court of the United States

51

October Term, 1941 Docket No. 882 ~~1083~~
C. C. A. No. 7616

In the Matter of

CHICAGO, MILWAUKEE, ST. PAUL & PACIFIC RAILROAD COMPANY, DEBTOR

TRUSTEES OF PRINCETON UNIVERSITY, ET AL., constituting the "UNIVERSITY GROUP" of General Mortgage Bondholders of CHICAGO, MILWAUKEE & ST. PAUL RAILWAY COMPANY

Petitioners

against

GROUP OF INSTITUTIONAL INVESTORS, ET AL.

Respondents

CROSS-PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT OF PETITION

FREDERICK J. MOSES
Attorney for Trustees of Princeton University et al., constituting the "University Group" of General Mortgage Bondholders of Chicago, Milwaukee & St. Paul Railway Company
70 Pine Street
New York City

March 20, 1942

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IN THE

Supreme Court of the United States

October Term, 1941 **Docket No. 882**

In the Matter of

CHICAGO, MILWAUKEE, ST. PAUL & PACIFIC RAILROAD COMPANY, Debtor.

TRUSTEES OF PRINCETON UNIVERSITY, *et al.*, constituting the "UNIVERSITY GROUP" of General Mortgage Bondholders of CHICAGO, MILWAUKEE & ST. PAUL RAILWAY COMPANY,

Petitioners,

against

GROUP OF INSTITUTIONAL INVESTORS, *et al.*, *Respondents.*

C. C. A. No. 7616

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioners are a group [1] of owners and holders of General Mortgage bonds of the Chicago, Milwaukee & St. Paul Railway Company, the predecessor of the Debtor.

[1] This Group was formed to assert and protect the rights of the General Mortgage Bondholders, in the Summer of 1940 when it became apparent that the Institutional and Savings Banks Groups, which had asserted those rights before the Commission, would acquiesce in the Commission's Plan of Reorganization. The members of the Group and their holdings of General Mortgage Bonds are:

The Trustees of Princeton University	$100,000
New York University	25,000
Milbank Memorial Fund	200,000
Bank for Savings of the City of New York	1,100,000
Union Square Savings Bank, New York City	550,000
Greenwich Savings Bank, New York City	179,000

(*Footnote continued on page 2*)

The Group of Institutional Investors and Mutual Savings Banks Group have heretofore, and on or about January 17, 1942, filed the record and a petition for a writ of certiorari to review the judgments of the United States Circuit Court of Appeals for the Seventh Circuit, entered in this cause on December 4, 1941, which reversed the order of the United States District Court for the Northern District of Illinois (which order approved a plan of reorganization for the Debtor, certified by the Interstate Commerce Commission), and remanded the proceedings to the Interstate Commerce Commission with directions that it make findings of fact as to values and other matters, "as indicated in the opinion" of that Court, thereby making the opinion a part of the judgment. In its opinion (R. 2312) the Court adjudged that "the fact situation permits of a plan such as the Commission formulated and approved. The Plan as such, ignoring the absence of findings, has support in the evidence. It violates no requirements (save findings) announced in the *Consolidated Rock Products* case" (312 U. S. 510).

(*Continuation of footnote from page* 1)

Bank of New York, as Trustee	130,000
New York Trust Company, as Trustee	70,000
U. S. Trust Company of New York, as Trustee for Individual Beneficiaries	481,000
Boston Insurance Company	75,000
Old Colony Insurance Company of Boston	30,000
New Amsterdam Casualty Co. of New York	176,000
First National Bank of Everett, Washington	25,000
Consolidated Investment Trust, Boston	400,000
Robert Winthrop, as Trustee and Guardian	296,000
Edgar Palmer, as Trustee	100,000
E. Sohier Welch and George E. Brown, as Trustees, Boston, Massachusetts	35,000
Grenville L. Winthrop, New York City	110,000
Wood, Struthers & Company, New York City	300,000
Charles M. Wood, Philadelphia, Pa.	247,000
Leo Wallerstein, New York City	50,000
Beekman Winthrop, Individually and as Trustee (now deceased) was a member	273,000

We do not oppose the Groups' petition and we file this Cross-Petition, believing it to be important that this Court now determine the questions of law arising out of Section 77 of the Bankruptcy Act (enacted in 1933) so that the lower courts and the Interstate Commerce Commission may terminate this and other proceedings for the reorganization of railroads, without unnecessary delay.

The petition of the Institutional and Savings Banks Groups raises only the question whether or not the Circuit Court of Appeals erred in holding findings of facts and values to be essential and in directing that they be made.

The proceeding involved, and the Circuit Court of Appeals decided a number of other important questions of Federal law (hereinafter stated) which have not been but should be settled by this Court, the final determination of which questions of law is important, not only in this cause but also in other proceedings for the reorganization of railroads. Some of those questions have been decided in a way, probably in conflict with applicable decisions of this Court.

Jurisdiction

The judgments of the Circuit Court of Appeals were entered on December 4, 1941 (R. 2318-2324). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A. Sec. 347).

Statutes Involved

The issues involve the construction of Section 77 of the Bankruptcy Act (11 U. S. C. A. 205) and its application to the facts of this case. The most pertinent provisions of that statute are reproduced as an appendix, *infra*, p. 31.

Opinions Below

The reports and orders of the Interstate Commerce Commission are reported at 239 I. C. C. 485 and 240 I. C. C. 257 (Original Report, R. 2153-2269, and Order R. 1258-1283; Supplemental Report, R. 1284-1317, and Supplemental Order, R. 1319-1347). The opinion of the District Court (R. 1857-1899) is in 36 F. Supp. 193. The opinion of the Circuit Court of Appeals (R. 2297-2317, 2334-35) has not yet been reported.

Statement of Matters Involved

The General Mortgage, made by the predecessor of the Debtor in 1889 (securing $150,000,000 of which $138,788,000 are outstanding in the hands of the public [R. 2269]), is a first lien on some 6,000 miles of railroad of which the elements of physical value, as appraised by the Interstate Commerce Commission for rate making purposes, are about $359,000,000 (R. 2215) and rolling stock, worth after depreciation about $49,000,000 over and above equipment liens on a part thereof, as of June 30, 1935.

In 1936, the only year as to which studies segregating the earnings of the several mortgage divisions were in evidence before the Interstate Commerce Commission, which earnings studies were accepted by the Interstate Commerce Commission and made the "basis" (R. 2251) of its plan, the 6,000 miles of General Mortgage Lines produced over 88 per cent. of the income available for fixed charges of the entire system of about 11,000 miles (Exh. 181, R. 723).

The annual interest on the General Mortgage bonds outstanding is about $6,000,000. The Commission's Report states that the earnings of the General Mortgage Lines for 1936 were $8,716,847, or $7,561,688 after deducting interest

on equipment obligations (R. 2250). It was proved before the District Court that during the first 3½ years of operation by the Trustees in Bankruptcy, from July 1, 1935 to December 31, 1938, the earnings of the General Mortgage Lines available for the payment of interest, were $26,817,802, or about $6,000,000 more than the bond interest accrued during that period (R. 220). The earnings of the System available for fixed charges for 1939 were nearly $10,000,000; for 1940, nearly $15,000,000 and for 1941 nearly $30,000,000.

There is in the record no finding, and no basis for a finding, that the General Mortgage bonds are not fully secured.

The Milwaukee & Northern and the General Mortgage Lines were the only Lines which were operated at a profit (Exh. 181, R. 723).

Regarding the "Lines West" (some 2860 miles of railroad extending from the Missouri River to the Pacific Coast), the Commission reported "We are satisfied that on any reasonable basis of allocation between the Lines West and the other parts of the System, the Lines West cannot be expected to earn any sum for the payment of interest" (R. 1307-8). This finding is confirmed by proof before the District Court that during the first 3½ years of operation by the Trustees in Bankruptcy, the "Lines West" had an operating deficit of $5,392,544 (R. 1780-81).

The Commission found the probable future earnings of the System available for the payment of fixed charges to be $7,859,106 (R. 2190), "considered to be a minimum" (R. 2219). This represents the Commission's estimate of what will be left of the future earnings of the General Mortgage and Milwaukee & Northern Lines after deducting the operating deficits of the other mortgage divisions. Of this $7,859,106 the Commission allocated to the General Mortgage bondholders only $1,563,682 (less than 1/5 of that $7,859,106) in fixed interest (R. 1317).

It was proved before the District Court that the Milwaukee and Northern Consolidated Lines have become permanently deficit lines (Court Exhs. 28, 29, 30, R. 1723, 1746-8).

The Plan discriminates against the General Mortgage Bondholders

Excepting the equipment liens which are undisturbed and undisturbable (§ 77 (j) of the Bankruptcy Act), there are only three classes of fully secured creditors. The Reconstruction Finance Corporation collateral loan of about $12,000,000; the Milwaukee & Northern First Mortgage $2,117,000 and the General Mortgage $150,000,000, of which a little less than $139,000,000 are outstanding in the hands of the public.

The Plan awards to the Reconstruction Finance Corporation 100 per cent.; to the Milwaukee & Northern First Mortgage bonds 70 per cent. and to the General Mortgage bonds only 25 per cent. of the face of their claims in new First Mortgage Fixed Interest bonds.

The General Mortgage secures bonds at the rate of about $25,000 per mile of General Mortgage Lines. Under the Plan, these bondholders would receive new First Mortgage Fixed Interest bonds at the rate of about $6,500 per mile on the General Mortgage Lines saddled with the deficits of the other lines.

The four classes of Terre Haute bondholders have liens aggregating about $22,000,000 (R. 2169) on 360 miles of road, leased to the Milwaukee—about $65,000 per mile. Under the plan the 120 miles fram Latta to Westport, Indiana, one-third of the whole Terre Haute road (Ct. Ex. 15, R. 1685), is to be abandoned (R. 2236) as worthless (Ex. 77, R. 300) which will make the Terre Haute mortgage liens about $97,700 per mile. The physical elements of value of the Terre Haute amount to about $1,000,000 less than the mortgage liens (R. 2215).

In addition to their liens on the Terre Haute line, they have an *unsecured* claim (R. 1304, 2213) against the *bankrupt* Debtor on its guaranty of the principal and interest of the Terre Haute bonds under a lease which the Court below referred to as "malodorous" (R. 2305) and unethical (R. 2311 footnote). Nevertheless, the Plan provides that the *solvent* reorganized Milwaukee shall guarantee the principal and fixed interest on all the Terre Haute bonds. For good measure, the Plan increases from 4% to 4¼% the interest on one-third of those bonds (R. 2169) (the Southern Indiana Fours) which are a first lien on the one-third of the road which is to be abandoned.

The Plan deprives the General Mortgage Bondholders of their priority without compensation

The proposed new First Mortgage is to be a lien upon the whole System, including the deficit lines. The General Mortgage bondholders receive only 25% of their claim in new First Mortgage bonds. Without compensation to them, 75% of their claim is subordinated to the other First Mortgage bonds to be issued and to the fixed interest on the Terre Haute bonds, whose claim against the bankrupt Debtor is unsecured.

There has been no determination of the disputed question of what property is subject to each mortgage

The Commission (on the ground that it has not jurisdiction to determine questions of law [R. 1151]), the District Court and the Circuit Court of Appeals all declined to determine the disputed question whether or not the General Mortgage is a first lien upon 17 pieces of profitable road, aggregating 574.94 miles (R. 221-2), which are cut-offs, branches and connections between points on the General Mortgage Lines and which are referred to in the record as "Pieces of Lines East."

In the allocation of earnings for 1936, the earnings of these "Pieces of Lines East" were credited to the 50-Year 5% Mortgage and not to the General Mortgage (Ex. 181, R. 723). The Commission in its report states that the propriety of so including these earnings is doubtful (R. 2252).

The "Net Revenue from Railway Operation" of these "Pieces of Lines East" in 1936 was $1,456,800, more than 70 per cent. as large as the corresponding revenue of the 2860 miles of "Lines West". After deducting taxes, etc., the "Total Income Available for Fixed Charges" of the "Pieces of Lines East" was $170,100 and of the "Lines West", a deficit of $1,108,535 (Ex. 181, R. 723).

The Plan diverts earnings available for fixed charges to Capital Investments

The Commission found the probable future earnings of the System annually available for fixed charges to be $7,859,106 and deducted enough to make the "coverage" about 1.16 leaving $6,759,654. Instead of applying the earnings available for fixed charges to the payment of fixed charges, as required by the statute § 77(b)(4) they have provided that $2,500,000 thereof shall be diverted to capital expenditures for the benefit of junior creditors who will become stockholders under the new Plan. The effect of this provision is to reduce the First Mortgage bonds issuable to the General and Milwaukee & Northern bondholders by $62,500,000, and during the 50-year life of the new First Mortgage to take away from the General Mortgage bondholders nearly $125,000,000 to which they are entitled as interest.

The Plan does not recognize the right of subrogation

The Commission has found that the only mortgage lienors entitled to receive new First Mortgage Fixed Interest bonds are the General and Milwaukee & Northern Mortgages.

Instead of permitting the Reconstruction Finance Corporation to satisfy its claim out of the collateral security for its note, the Plan provides that the R. F. C. shall receive 100 per cent. of its claim in new First Mortgage Fixed Interest bonds, thereby reducing the number of such bonds distributable to the General and the Northern bondholders. Instead of subrogating the latter, at whose expense the debt to the R. F. C. is to be paid, to the rights of the R. F. C. in that collateral, the collateral is treated under the Plan as being subject to the lien of the 50-Year 5% Mortgage. This collateral and the "Pieces of Lines East" are the only assets, having any value, on which the 50-Year Mortgage can claim a prior lien.

The Plan gives to the General Mortgage Bondholders no compensation for the surrender of their senior rights and priority

The Plan awards to the General Mortgage bondholders only "the face amount of inferior securities equal to the face amount of their claims," namely, 25% of their claim in new First Mortgage Fixed Interest bonds; 35% in Second Mortgage Income bonds, upon which interest can be paid only if earned over and above the First Mortgage interest and the $2,500,000 capital fund for Additions and Betterments; 20% in Second Mortgage Series B Income bonds, upon which the interest can be paid only after the foregoing and (in the discretion of the directors of the Railroad who will represent the stockholders) after the payment of an additional $2,500,000 annually into the capital fund for Additions and Betterments; and 20% in the Preferred Stock of the reorganized company.

The junior and inferior 50-Year 5% bonds receive a part of the Series B Income bonds and are thus placed on a parity with 20% of our claim and are given priority over the 20% of our claim for which we are to receive Preferred Stock.

The old preferred stock was found to be worthless because it would require earnings of about $29,000,000 to pay its dividends. It has been computed that under the present tax law it would require nearly $44,000,000 earnings to pay the dividends on the new Preferred Stock.

The Milwaukee never earned as much as $33,000,000 in any year (R. 2180).

The court below held that the Commission "is not required" to receive additional evidence

The judgment of the Circuit Court of Appeals decreed that the order of the District Court be reversed "and that this cause be and it is hereby remanded to the said District Court with directions * * * to remand the case to the Interstate Commerce Commission for the making of findings and, *if necessary, the taking of additional evidence* that additional findings may be made *as indicated in the opinion of this Court filed herein*" (R. 2323) thereby making the opinion a part of the judgment of the Court and a mandate to the Interstate Commerce Commission. (Italics ours.)

Thereafter, on a motion to modify the opinion, the Circuit Court of Appeals handed down an opinion, *per curiam,* in which the final sentence reads, "In other words, the I. C. C. has jurisdiction of the matter and *may, although it is not required to do so, re-examine the evidence, or receive additional evidence,* if in its judgment, justice to the parties requires it" (R. 2335). (Italics ours.)

Questions Presented

1. Whether or not a plan of reorganization which gives to one class of fully secured creditors less favorable treatment than is accorded to other fully secured or unsecured creditors be discriminatory?

2. Whether or not senior creditors may lawfully be deprived of their priority by allocating to them, without compensation, 75% of their claim in junior and subordinate bonds and stock?

3. Whether or not it be essential to the determination of the fairness of an allocation of securities among *railroad* mortgage bondholders, that there be a determination of what property is subject to each mortgage? (This Court held in the *Consolidated Rock Products* case that the failure to determine what property is subject to each mortgage is "fatal" to a plan of reorganization of a *business* corporation.)

4. Whether or not, when the Commission has found (as provided in Sec. 77 (b) (4) of the Bankruptcy Act) what are the probable future earnings available for the payment of fixed charges, after deducting adequate coverage, there be any authority under the statute to divert to capital expenditures any part of the earnings so found to be available for the payment of fixed charges?

5. Whether or not in a railroad reorganization proceeding under Section 77 of the Bankruptcy Law, creditors, at whose expense the claim of a secured creditor is to be paid under the Plan, be entitled to be subrogated to the rights of that secured creditor in the collateral held by it as security for its claim?

6. Whether or not when junior lienors and creditors are participating in a plan for the reorganization of a *railroad,* the prior rights of senior creditors be recognized if they be given only the face amount of inferior securities equal to the face amount of their claims?

7. Whether in a railroad reorganization under Section 77 of the Bankruptcy Act creditors whose claims are secured by mortgage on valuable revenue producing railroad lines can be required to accept bonds secured by a mortgage on those lines combined with other lines operated at a deficit which will consume a substantial part of the earnings of the lines which now secure their claims?

8. Whether or not it be fair, equitable and lawful under the guise of reducing the debt of a railroad corporation, to allocate to secured creditors preferred stock instead of income bonds, with the result that the reorganized company cannot, because of taxation, pay dividends on such preferred stock unless it shall earn many times the probable future earnings as ascertained by the Commission?

9. Whether or not it be, as a matter of law, the duty of the Interstate Commerce Commission, when a proceeding under Section 77 of the Bankruptcy Act be remanded to it, to receive additional evidence of changed conditions affecting the value and the earning capacity of the Debtor, its several mortgage divisions and its leased line, including the evidence received before the District Court, or whether it be lawful, after a lapse of four years, for the Commission, in its discretion, to refuse to receive and consider such evidence and to base its findings and its new plan of reorganization solely on the evidence which was before it when its hearing of evidence closed?

Reasons Relied on for the Allowance of the Writ

The opinion of the Court below having been incorporated in its judgment, the Interstate Commerce Commission will obey the mandate of that opinion in the formulation of a new report and plan.

That Court therein has decided important questions of federal law which have not been, but should be settled by this Court, some of which questions have been decided in a way probably in conflict with applicable decisions of this Court.

If the Circuit Court of Appeals be in error in the determination of any of the foregoing questions the proceeding would have to be remanded to the Interstate Commerce Commission a third time. Meanwhile, other railroad reorganization proceedings are pending, both before the Commission and in the District Courts, in which some or all of these questions have arisen, or will arise. We believe it to be important that the law governing railroad reorganizations, under Section 77 of the Bankruptcy Act, be settled as soon as may be, not only in order that this proceeding may reach an early final determination but also that the Interstate Commerce Commission and the lower Courts may apply the proper rules of law to other reorganization proceedings.

WHEREFORE, your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the Circuit Court of Appeals for the Seventh Circuit, commanding that Court to certify and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all of the proceedings in the cases numbered on its docket Nos. 7590, 7610-7617, and especially No. 7616, the appeal of The Trustees of

Princeton University, and others, constituting the "University Group" of General Mortgage Bondholders of Chicago, Milwaukee & St. Paul Railway Company, and entitled,

"In the Matter of Chicago, Milwaukee, St. Paul and Pacific Railroad Company, Debtor; Trustees of Princeton University, *et al.*, Constituting the 'University Group' of General Mortgage Bondholders of Chicago, Milwaukee & St. Paul Railway Company, *vs.* Group of Institutional Investors, etc., *et al.*, Appellees (And Consolidated Appeals)," and that the judgment of the Circuit Court of Appeals for the Seventh Circuit may be modified as to the matters set forth in this Cross-Petition; and they further

Respectfully pray that this cause be advanced for hearing out of its regular order, to come up at or about the same time with the cause of *The Western Pacific Railroad Company,* which cause presents some but not all of the questions herein propounded, and that your petitioners may have such other and further relief in the premises as to this Court may seem proper.

FREDERICK J. MOSES,
Attorney for Trustees of Princeton University, et al., constituting the "University Group" of General Mortgage Bondholders of Chicago, Milwaukee & St. Paul Railway Company.

BRIEF

IN SUPPORT OF THE CROSS-PETITION FOR WRIT OF CERTIORARI TO WHICH THIS BRIEF IS ANNEXED

The foregoing Cross-Petition contains reference to the reports of the opinions below (p. 4); the grounds on which the jurisdiction of this Court is invoked (p. 3); and a concise statement of the case (pp. 4-10) as required by Rule 27. In the interest of brevity we refer to them here instead of repeating them.

SUMMARY OF ARGUMENT

The Court below erred in holding

(1) That unequal treatment of classes of fully secured creditors is not discriminatory;

(2) That the priorities of senior creditors may be destroyed by allocating to them, without compensation, 75% of their claim in subordinate securities;

(3) That it is unnecessary to determine conflicting claims as to what property is subject to each of two mortgages to which new securities are allocated;

(4) That "probable earnings" found by the Commission to be available for fixed charges may be used for capital investments;

(5) That creditors, at whose expense a secured creditor is paid, are not entitled to be subrogated to the rights of the creditor so paid in the collateral held by him;

(6) That, where junior creditors participate in a plan of reorganization of a railroad, the prior rights of senior creditors are recognized when they are given only the face amount of inferior securities equal to the face of their claims.

(7) That creditors secured by a prior lien on valuable property, can be required to take bonds secured by that property combined with worthless property, the deficits of which will consume a substantial part of the earnings of the original security;

(8) That the priority of senior creditors may be destroyed by alloting to them stock upon which, because of taxation, there is no probability that dividends can be paid;

(9) That the Interstate Commerce Commission "is not required to" receive and consider additional evidence of facts which have transpired during the four years elapsed since the evidence was closed before the Commission.

ARGUMENT

POINT I

A plan which treats one class of fully secured creditors less favorably than other fully secured or unsecured creditors is discriminatory and unlawful.

The statute, sec. 77 (e) (1) provides that the Plan must not "discriminate unfairly in favor of any class of creditors."

It is axiomatic that no creditor, however great be the security for his claim, is entitled to more than payment in full. It is a fundamental principle of the Bankruptcy Law that no fully secured creditor can be deprived of his security without satisfaction of his claim.

The claim of the Reconstruction Finance Corporation for about $12,000,000 is fully secured by collateral. The Plan awards to the R. F. C. one hundred per cent. of its claim in new First Mortgage Fixed Interest bonds. The Milwaukee & Northern First Mortgage bonds, aggregating $2,117,000, are fully secured by property having physical elements of value of over $4,200,000 earning more than the bond interest (R. 2248). The Plan allots to them 70 per cent. of the face of their claim in new First Mortgage Fixed Interest bonds and 30 per cent. in Second Mortgage Contingent Interest Series A bonds.

The General Mortgage, made in 1889, is fully secured by a first lien on about 6,000 miles of railroad, constituting the "Heart of the System," including terminals, shops for the building and repair of cars and locomotives and everything that goes to make up a complete railroad system, having physical elements of value of about $359,000,000 (R. 2215, 50; I. C. C. Bureau of Valuation Report Sheet 4). This does not include the Pieces of Lines East. It is a lien on locomotives, cars and other equipment, the equity in which is valued at about $49,000,000. This Mortgage secures $150,000,000 bonds, of which less than $139,000,000 are outstanding in the hands of the public, the balance being owned by the Company and pledged as security for the claim of the Reconstruction Finance Corporation.

For nearly fifty years the interest on the General Mortgage bonds was paid regularly until this proceeding was commenced in June, 1935. Their annual interest amounts to a little less than $6,000,000. The Report states that in 1936 the income available for interest of the General Mortgage Lines was over $8,700,000, and after deducting interest on equipment obligations, more than $7,500,000 (R. 2250); 1.16 times the interest on all the bonds, including those pledged with the R. F. C., and about 1.27 times the interest on the bonds in the hands of the public (Ex. 181, R. 723).

The record shows that during the first 3½ years of operation by the Trustees in Bankruptcy, ending December 31, 1938, the General Mortgage Lines (not including the Pieces of Lines East (R. 231), earned for interest more than $26,800,000—about $6,000,000 more than the bond interest (R. 229).

The Earnings Studies, which were made the "basis" (R. 2251) of the Commission's Report, assembled in Exhibit 181 (R. 723), show that the General Mortgage Lines earned more than 88 per cent. of the income available for fixed charges of the System and that with the exception of the Milwaukee & Northern they were the only Lines owned by the Milwaukee operated at a profit.

The earnings for 1939, 1940 and 1941 were much larger than those of the four preceding years.

There has been no finding, and there is no basis for a finding, that the General Mortgage bonds are not fully secured. Nevertheless, the Plan, which allots to other fully secured creditors 100 per cent. and 70 per cent. of their claims in New First Mortgage Fixed Interest bonds, allots to the General Mortgage bondholders only 25 per cent. of their claim in new First Mortgage bonds; 35 per cent. in Series A Second Mortgage Income bonds; 20 per cent. in Series B Second Mortgage Income bonds and 20 per cent. in Preferred Stock.

The finding of the Commission that the probable future earnings available for the payment of fixed charges of the Milwaukee System—$7,859,106—represents what the Commission estimates will be left of the earnings of the General Mortgage Lines after paying therefrom the deficits of the unprofitable lines. The Plan allots to the General Mortgage Lines $1,563,682 (less than one-fifth of that $7,859,106) as interest on new First Mortgage bonds (R. 1317).

The Circuit Court of Appeals in its opinion said that there were huge sums of interest unpaid on the General Mortgage bonds. That unpaid interest has all accumu-

lated since the property was placed in the hands of the Trustees in Bankruptcy. It remains unpaid, not because it was not earned but because the money was used for other purposes and accumulated in the hands of the Trustees in Bankruptcy who had in cash more than $35,000,000 on December 31, 1941.

The discrimination in favor of the unsecured claims of the Terre Haute bondholders (described on pp. 6 and 7) is fantastic.

We pray that the Court declare the law to be that a plan which gives to one fully secured creditor less favorable treatment than is accorded another fully secured or unsecured creditor is discriminatory and unlawful.

POINT II

The provisions of the Plan allocating to the General Mortgage Bondholders only 25% of their claim in new First Mortgage bonds and subordinating 75% of their claim, deprive them of their priority without compensation.

We have now a first lien prior to all the world, including the public interest (see *Louisville Bank* v. *Radford*, 295 U. S. 555, 601-2 citing the 5th Amendment to the Constitution), on practically all of the valuable property owned by the Debtor.

Our first lien is reduced to 25% of our claim. 75% is subordinated to the rest of the new First Mortgage bonds and to the fixed interest on the Terre Haute bonds whose claim against the bankrupt Debtor is unsecured.

This is in violation of the "full and absolute priority rule" established in *Northern Pacific Railway Co.* v. *Boyd*, 228 U. S. 482, which was reiterated and emphasized in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, and in *Consolidated Rock Products Co.* v. *Du Bois*, 312 U. S. 510.

POINT III

A determination of what property is subject to each of the several mortgages is essential in the formulation of a plan of reorganization.

The statute, sec. 77 (e) (1), provides that the Plan must "conform to the requirements of the law of the land."

In the *Consolidated Rock Products* case (312 U. S. 510, p. 524) this Court declared that the absence of such a determination is "fatal" to a plan of reorganization.

The decisions of the Circuit Court of Appeals and of the District Court in this case are in conflict with that rule.

The "Pieces of Lines East"—seventeen separate short lines, aggregate about 575 miles. Only one of them connects with any other than the General Mortgage Lines (R. 221-2). They are operated at a profit over charges and in 1936 produced "net revenue from railroad operations" $1,456,800 (Ex. 181, R. 723), more than 70 per cent. as much as the like revenue produced by the 2860 miles of deficit "Lines West" (Ex. 181, R. 723). Either they are or they are not subject to the lien of the General Mortgage.

The Commission expressly declined to decide whether or not these "Pieces of Lines East" are subject to the General Mortgage upon the ground that it is a judicial question for determination by the Courts (R. 1151) and said in its report:

> "The propriety of crediting the First and Refunding Mortgage or the 50-Year Mortgage with the earnings of the 'Pieces of Lines East' is rendered doubtful in the absence of a judicial determination of the question whether these lines are subject to the first lien of the first and refunding mortgage or to that of the General Mortgage" (R. 2252).

The failure to make this determination was one of our objections to the Plan (R. 1424); and one of our points on appeal to the Circuit Court of Appeals (R. 2069). The question was argued both orally and by brief before both Courts and neither Court determined that question.

It was not included in the list of matters referred back to the District Court by the Circuit Court of Appeals (R. 2308-9).

If the writ be granted we shall ask this Court to decide that question of law which was not decided below.

POINT IV

Section 77 of the Bankruptcy Law does not invest in the Interstate Commerce Commission, or in the Court, the power to divert to capital expenditures any part of the probable future earnings which the Commission shall find to be available for the payment of fixed charges.

Section 77(b) (4) directs that the Commission

> "Shall provide for fixed charges (including interest on funded debt, interest on unfunded debt, amortization of discount on funded debt and rent for leased railroads) in such an amount that * * * there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof; * * *."

The Commission has found the probable earnings available for the payment of fixed charges ("the average for the five years—1931-5—considered to be a minimum" [R. 2219]) to be $7,859,106 and that a coverage of 116% is adequate, leaving $6,769,654 applicable to the payment of fixed charges as provided by the Statute (R. 2219 and 2190).

Its Report (R. 2219) recites that the Committee of the Group of Institutional Investors had proposed that the probable earnings available after deducting adequate coverage be applied to the payment of fixed charges and that an Additions & Betterments Fund be provided, *not* out of probable minimum net earnings available for fixed charges but out of the estimated earnings for the future normal year.

The Commission did not find that such a plan would be unsound, but it said:

> "* * * a *sounder course* would be to *include the obligatory payment* for the (Additions and Betterments) fund *with the proposed fixed interest charges* keeping the total within the coverage of the past average earnings determined as before. If the fixed interest charges be limited to about $4,269,654 and the mandatory payment to the fund to $2,500,000 a year, the total, $6,769,654, would be covered about 1.16 times by the average earnings for the period 1931 to 1935 and 1.18 times for the period 1932 to 1936 * * *. We conclude that the limitation of *fixed charges* of the System at approximately $4,269,654 a year is reasonable and proper. We find that there will be adequate coverage of such amount of fixed charges of the new company by the probable earnings available for the payment thereof" (R. 2219). (Italics ours.)

Instead of complying with the law and applying to the payment of *fixed charges* the "probable earnings available," the Commission has provided that $2,500,000 of these earnings shall be used for *capital expenditures,* which should be paid from capital funds or surplus earnings. This provision is not only unfair and inequitable, but we insist that it is unlawful, and beyond the powers granted by the statute.

This provision reduces by $62,500,000 the new First Mortgage Fixed Interest bonds upon which the "probable earnings available" would pay the fixed charges. Practically all of those bonds would be distributable to General Mortgage bondholders. During the fifty year life of the

new bonds, $125,000,000, which should be paid in interest, would be diverted to capital investments for the benefit of junior classes of creditors who will receive stock for their claims.

This is a proceeding under a statute which is in derogation of the common law. It must be strictly construed. It provides that the probable earnings available for the payment of fixed charges shall be used for the payment of fixed charges. The statute grants no power to use them for any other purpose.

The need for a strict construction of the grant of power is emphasized by the fact that we have here the anomalous position of the body which fixes the rates upon which railroad earnings depend, also clothed with authority to cut down the railroads' capitalization to fit the rates which it had previously made—wiping out in this instance hundreds of millions and in the aggregate of all reorganized railroads, billions of actual invested capital. Having done that they may again reduce the rates to fit the new capitalization and so *ad infinitum,* or rather *ad infinitessimum.*

This is the vicious circle condemned by Mr. Justice BRANDEIS in *Southwestern Telephone Co.* v. *Public Service Commission,* 262 U. S. 276, p. 292.

POINT V

Creditors at whose expense another secured creditor is paid are entitled to be subrogated to the rights of the latter in the collateral which was held as security for his claim.

The claim of the Reconstruction Finance Corporation of about $12,000,000 is secured by $11,212,000 Series G General Mortgage Bonds, by the 1st and Refunding Mortgage Bonds and by other collateral, including the Terre Haute stock.

The Plan provides that instead of permitting the Reconstruction Finance Corporation to realize on its col-

lateral, the loan shall be paid 100% in New First Mortgage bonds.

This reduces by about $12,000,000 the First Mortgage bonds which would be distributable to General and Milwaukee & Northern bondholders.

For all practical purposes the loan is being paid by the Generals and Northerns. In fairness and equity they should be subrogated to the rights of the Reconstruction Finance Corporation.

> "• • • the equitable doctrine of subrogation • • • has been steadily growing in importance and widening its sphere of application. It is a creation of equity and is administered in the furtherance of justice. It is applied to give the party who pays the debt the full benefit and advantage of such payment."
>
> *Rachal* v. *Smith,* 101 Fed. 159 (C. C. A. 5th).

> "The doctrine of subrogation is one of equity and not of the common law and, in its application, no attention should be paid to technicalities which are not of an insuperable character, but broad equities should always be sought out as far as possible."
>
> *Merchants & M. Transport Co.* v. *Robinson & Co.,* 191 Fed. 769-772 (C. C. A. 1st).

> "These Federal cases clearly reflect the rule requiring liberal application of the doctrine of subrogation, and we think they have so far committed the Federal Courts to that rule that we ought not to refuse to follow the path they have chosen."
>
> *Burgoon* v. *Lavezzo,* 92 Fed. 2nd 726-36 (Ct. of Appeals, D. C. '37).

The Series G General Bonds and the 1st & Refunding Bonds held by the Reconstruction Finance Corporation are to be cancelled under the Plan.

Under the Plan, the allocation of securities to the 50-Year Mortgage is based on the fact that that mortgage is now a second lien on the security on which the 1st & Re-

funding Mortgage is now a first lien. It makes that security and the claim that the 50-Year Mortgage will then be a first lien on the "Pieces of Lines East" the basis of allotting to the 50-Year Mortgage about $19,000,000 of Class B Contingent Interest bonds, on a parity with 20% of the General Mortgage bondholders' claim, and gives them priority over the 20% Preferred Stock allotted to the Generals.

These allotments absolutely ignore the fact that this loan is to be paid, the 1st & Refunding Bonds cancelled, and these assets freed at the expense of the General Mortgage bondholders, and ignores their right to subrogation to the rights of the Reconstruction Finance Corporation.

POINT VI

The Plan in which junior interests participate does not "afford due recognition" to the prior rights of the General Mortgage Bondholders by giving them "only the face amount of inferior securities equal to the face amount of their claims."

In the *Consolidated Rock Products* case (312 U. S. 510, pp. 528-9) this Court declared that to be the law where *stockholders* participate, and declared that "They (bondholders) must receive, in addition, compensation for the senior rights which they are to surrender" (312 U. S. 510, p. 529).

The same opinion stated that "Unless meticulous regard for earning capacity be had, indefensible participation of *junior securities* in plans of reorganization may result" (312 U. S. 510, pp. 525-6). (Italics ours.)

So we feel justified in asserting that this Court intended the rule to apply as between senior and junior creditors.

Nevertheless the Commission expressly refused to give the General Mortgage bondholders any additional compensation for their senior rights (R. 2255).

POINT VII

The inclusion of the deficit lines in the new First Mortgage unlawfully deprives the General Mortgage Bondholders of their security, their priority and their property.

The General Mortgage Lines upon which we have a prior lien have a value far beyond the amount of our mortgage. They constitute a complete railway system which has always operated at a profit over its bond interest.

The bankruptcy of the Milwaukee has resulted from taking General Mortgage earnings to pay operating deficits of the "Lines West", and interest on the 50 Year 5% bonds.

The Commission has found that those lines cannot be expected to earn anything for the payment of interest.

As this Court has established the law that earning capacity is the sole criterion of value—no commercial value can be attributed to them. The only possible justification for their continued operation is to render service to the public. But, if the public interest require their continued operation it should be done at public expense.

The reason that the Commission's estimate of probable future earnings is so small is because the operating deficits of the "Lines West" must first be deducted from the earnings of the General Mortgage Lines, and the Plan proposes to saddle upon those earnings, not only the operating deficits but also the cost of additions and betterments to the "Lines West".

In order to accomplish this public benefaction, our priority and our lien are destroyed; we receive only twenty-five per cent. in new First Mortgage bonds, the security for which is less valuable than our present security; seventy-five per cent. of our claim is subordinated to the other first mortgage bonds to be issued and to the principal of and fixed interest on the Terre Haute bonds,

and for that 75% of our claim we are offered progressively inferior engravings which cannot be dignified with the name "securities".

This does not "afford due recognition to our rights"; it does not "conform to the requirements of the law of the land," as established by the Fifth Amendment to the Constitution and the decisions of this Court in *Louisville Bank* v. *Radford*, 295 U. S. 555, pp. 601-2 and *Consolidated Rock Products Co.* v. *Du Bois*, 312 U. S. 510.

POINT VIII

The provisions for the issuance to the General Mortgage Bondholders of 20% of their claim in preferred stock is, by reason of the Tax Laws, confiscation.

Having limited the fixed interest debt to about $109,000,000 the Commission stated no reason for limiting the contingent interest debt to $115,000,000 and issuing about $323,000,000 of stock to represent about 60 per cent. of the new capitalization (R. 1317).

With the bonded indebtedness reduced to about 40% of the total new capitalization, the Additions and Betterments Fund and Sinking Fund payments would be subject to income taxes and everything above $9,500,000 fixed and contingent interest would be subject to both income and excess profits taxes.

The Revenue Act of 1941 is now the law of the land of which this Court will take judicial notice. The rates of taxation are no longer a matter of estimate or guesswork.

Under the present tax law, $20,000,000 income would not be sufficient to pay all of the contingent interest. It will require about $44,000,000 earnings (more than ten times the fixed charges established by the Plan) to pay the Preferred Stock dividends and the earnings would have to reach astronomical figures to pay the $3.50 dividends

contemplated by the Plan (R. 2242) on the $215,000,000 common stock. The Milwaukee never earned as much as $33,000,000.

The S. E. C. sends people to prison for issuing worthless securities.

The avowed purpose of reducing the bonded indebtedness to such a low figure is to make sure that the reorganized company can carry on in periods of possible low earnings. Income bonds, contingent on earnings, with voting rights would be just as effective for that purpose and if the Company continue to prosper those who loaned their money would get returns on their investment. It is not "compatible with the public interest" to so arrange the new capitalization that those returns will go instead to the Government in taxes, because it is unfair, inequitable and confiscatory. Confiscation is never "compatible with the public interest," except as a penalty for wrongdoing.

POINT IX

The decision of the Circuit Court of Appeals should be modified by directing the Interstate Commerce Commission to consider the evidence received before the District Court and to receive and consider other relevant evidence as a basis for its findings.

The judgment upon each appeal directs the District Court "To remand the case to the Interstate Commerce Commission for the making of findings, and, *if necessary,* the taking of additional evidence that additional findings may be made *as indicated in the opinion of this Court filed herein*" (R. 2318-24). (Italics ours.) That opinion is thus a part of the judgment and is a mandate to the Interstate Commerce Commission as to the rules which shall govern its action.

If some parts of that mandate be erroneous they should be reviewed by this Court in order that the law

applicable to this and other similar proceedings may be finally established and the judgment modified accordingly.

On an application to modify the opinion, the Court said: "In other words, the *Interstate Commerce Commission has jurisdiction of the matter and may, although it is not required to do so, re-examine the evidence, or receive additional evidence, if, in its judgment, justice to the parties requires it*" (R. 2335). (Italics ours.)

1937 was the last full year's earnings available when the evidence before the Commission was closed in March, 1938. Since that time the earnings of the Debtor, and of other railroads, have multiplied. In 1939, the Milwaukee earned nearly $10,000,000 available for fixed charges; in 1940, it earned nearly $15,000,000 and in 1941, it earned nearly $30,000,000. These increased earnings are the result not only of increased gross revenues but of efficient and economical operation, reduced costs, reduced interest rates on equipment trust certificates, reduction in the outstanding debt, the introduction of Diesel locomotives and many other factors, some of which were proved before the District Court.

The evidence before the Interstate Commerce Commission showed that the Milwaukee and Northern Consolidated Mortgage Lines had, prior to 1937, more than earned the interest on the bonds, and the Plan treats those bonds on that basis. Before the District Court it was proved that by reason of an "Ore Pooling Agreement", approved by the Interstate Commerce Commission, they had become permanently deficit lines. Their deficit in 1939 exceeded $500,000 (R. 1723, 1746-8).

Section 77(e) provides that "The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power, past, present and prospective, and all other relevant facts." The earnings of 1939-41 are now past earnings.

Atcheson, Topeka & Santa Fe Railroad v. *United States,* 284 U. S. 248, was a suit in equity to nullify an

order of the Interstate Commerce Commission in a rate case under the Interstate Commerce Commission Act. The Commission had taken testimony down to 1928 and made an order in 1931 fixing rates based upon the conditions existing during and prior to 1928. This Court held that it would take judicial notice of the fact that economic conditions affecting railroads had changed and that while such an order might have been proper at the time when the testimony was closed, changes in economic conditions made it no longer fair.

The same rule should apply here where the evidence before the Commission was closed four years ago and an even greater change in railroad earnings has occured during those four years than occurred between 1928 and 1931.

In empowering the Interstate Commerce Commission to estimate the probable future earnings available for the payment of fixed charges, and to make that estimate the basis of its plan of reorganization, the Congress did not, and did not intend to, endow the Commission with prophetic omniscience. This contention is supported by the provision of the Statute authorizing the District Court to receive additional evidence (§ 77 (e)).

That bondsholders who have invested hundreds of millions of dollars in the mortgage bonds of this Railroad should be deprived of their property without compensaiton because the Commission made a bad guess in 1940, based upon conditions which existed before 1938, would be a travesty of justice.

New York, March 20, 1942.

Respectfully submitted,

FREDERICK J. MOSES,

Attorney for Trustees of Princeton University, et al., constituting the "University Group" of General Mortgage Bondholders of Chicago, Milwaukee & St. Paul Railway Company.

APPENDIX

The provisions of Section 77 (11 U. S. C. A. 205) most pertinent in this case are the following:

"(b) A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; * * * (4) shall provide for fixed charges (including fixed interest on funded debt, interest on unfunded debt, amortization of discount on funded debt, and rent for leased railroads) in such an amount that, after due consideration of the probable prospective earnings of the property in light of its earnings, experience and all other relevant facts, there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof; * * *

* * *

"(d) * * * the Commission shall render a report and order in which it shall approve a plan, which may be different from any which has been proposed, that will in its opinion meet with the requirements of subsections (b) and (e) of this section, and will be compatible with the public interest; or it shall render a report and order in which it shall refuse to approve any plan. In such report the Commission shall state fully the reasons for its conclusions. * * *

"(e) Upon the certification of a plan by the Commission to the Court * * * all parties in interest * * * may file with the Court their objections to such plan, * * * and their claims for equitable treatment. The judge shall * * * hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing, * * * the judge shall approve the plan if satisfied that (1) it com-

plies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; * * *

"If the judge shall not approve the plan, he shall file an opinion, stating his conclusions and the reason therefor, and he shall enter an order in which he may either dismiss the proceedings, or in his discretion and on motion of any party in interest refer the proceedings back to the Commission for further action, in which event he shall transmit to the Commission a copy of any evidence received. * * *

* * *

"If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the Court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts.

* * *

"(j) * * * The title of any owner, whether as trustee or otherwise, to rolling-stock equipment leased or conditionally sold to the debtor, and any right of such owner to take possession of such property in compliance with the provisions of any such lease or conditional sale contract, shall not be affected by the provisions of this section."

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. [redacted] 47

IN THE MATTER OF

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY,

Debtor and Cross Petitioner.

~~No. 875-883~~

GROUP OF INSTITUTIONAL INVESTORS, and MUTUAL SAVINGS BANK GROUP,

Petitioners,

vs.

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, *et al.*,

Respondents.

~~No. 988~~

RECONSTRUCTION FINANCE CORPORATION,

Petitioner,

vs.

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, *et al.*,

Respondents.

CROSS PETITION OF CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

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Dated, New York, N. Y.,
March 16, 1942.

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To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Chicago, Milwaukee, St. Paul and Pacific Railroad Company (herein called the Railroad Company), respondent in the Proceedings Nos. 875-883 upon the Docket of this Court, opposes as unwarranted the granting of a *writ of certiorari* as asked by the Group of Institutional Investors and Mutual Savings Bank Group, the Petitioners therein, for the pur-

pose of a review of the decision of the Circuit Court of Appeals for the Seventh Circuit, filed December 4, 1941. The Railroad Company's reasons for asking that the Petition of these two Groups be denied will be presented in an opposing Brief filed under these Docket numbers.

The Railroad Company nevertheless believes it essential, in order that it may not be held to have accepted as the law of this case the Opinion and Supplemental Opinion of the Circuit Court of Appeals and in order that vital interests of its security holders may be protected, to apply by way of a Cross Petition for a *writ of certiorari* for a review of the decision of the Circuit Court of Appeals on grounds differing from and wholly unrelated to those urged in the Petition filed by the two Groups.

For all purposes of this Cross Petition, the Railroad Company asks leave to refer to the certified Transcript and printed copies of the Records filed by the two Groups, as Petitioners in the Proceedings Nos. 875-883, and further asks that all such documents be deemed to accompany this Cross Petition within the requirements of Rule 38 of this Court.

Reasons for Review

The basic reasons which the Railroad Company urges for a review of the decision of the Circuit Court of Appeals are—

> (a) that the decision of the Circuit Court of Appeals should be brought into harmony with the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois*,* and

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* This case is reported in 312 U. S., at page 510. In the interest of brevity the citation of the volume and page will be omitted in subsequent references throughout this Cross Petition and the annexed Brief.

(b) that this Proceeding should be referred back to the Interstate Commerce Commission in accordance with subsection (e) of Section 77 of the Act of Congress commonly known as the Bankruptcy Act (11 U. S. C. A., Sec. 205) for reconsideration under the provisions of the preceding subsection (d) unembarrassed by so much of the decision of the Circuit Court of Appeals as is inconsistent with the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois.*

The propriety of a review of the decision of the Circuit Court of Appeals on these grounds is accentuated by the decision of the same Circuit Court of Appeals released February 9, 1942, relating to the pending reorganization of the Chicago and North Western Railway Company, in which that Court appears to have held that compliance with the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois* may be dispensed with after a Plan of Reorganization certified to the District Court by the Interstate Commerce Commission "has the approval of the various groups of creditors"—a conclusion which seems an inexplicable one when it is considered—

(a) that under Section 77 of the Bankruptcy Act judicial approval must *precede* the submission of the Plan to creditors and the very purpose of the requirement for specific findings is to enable the Court properly to perform its judicial functions thereunder, and

(b) that in the present case the Circuit Court of Appeals (we think quite properly) *stayed* the submission of the Plan to the creditors of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company

until the determination of the appeal then pending before it from the decision of the District Court—a stay which it declined to release and which still stands notwithstanding successive applications for its release by the Interstate Commerce Commission and by the two Groups (Tr. 2274; 2296).

For the purposes of this Cross Petition and the annexed supporting Brief, it will be sufficient to specify and limit the discussion to the more conspicuous features of the Plan of Reorganization and the decision of the Circuit Court of Appeals in respect thereto which the Cross Petitioner contends are at fundamental variance with the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois* and which accordingly justify the issuance of a *writ of certiorari* under subdivision (b) of Paragraph 4 of Rule 38 of this Court.

These include—

(a) the treatment accorded holders of the General Mortgage Bonds,

(b) the treatment accorded the holders of the Fifty Year Mortgage 5% Bonds, and

(c) the treatment accorded the holders of the Railroad Company's Preferred Stock and Common Stock.

Even as to these subjects it will be unnecessary to do more than refer to the bald outlines of the Plan.

The financial structure of the Railroad Company is shown in detail in the original Report of the Interstate Commerce Commission (Tr. 2165-2269; Debtor's Court Exhibit 8). The Plan certified to the District Court by the In-

terstate Commerce Commission in tabulated form is attached to the Supplemental Report of the Interstate Commerce Commission (Tr. 1317).

The General Mortgage Bonds are outstanding in the amount of $138,788,000, divided into five Series bearing interest rates varying from 3½% to 4¾%, all maturing May 1, 1989, and secured primarily by a first lien on 6,000 miles of railroad of high traffic density lying between the Missouri River and Lake Michigan. Under the Plan of Reorganization these General Mortgage Bonds, which had weathered every storm in the 46 year period preceding the filing of the Petition under Section 77 of the Bankruptcy Act, are offered for the full principal and accrued interest at the effective date of the Plan—25% in new First Mortgage 4% Bonds, 35% in General Mortgage 4½% Income Bonds, Series A, 20% in General Mortgage 4½% Income Bonds, Series B, and 20% in 5% Preferred Stock (Tr. 1317, 1340).

The Fifty Year 5% Bonds of 1975 are outstanding in the amount of $106,395,096, and are secured by a lien (for practical purposes a first lien) on approximately 3,000 miles of railroad lying between the Missouri River and Puget Sound, and other properties, and by a second lien on all the properties upon which the General Mortgage is a first lien. Under the Plan of Reorganization these Fifty Year Bonds are offered for the full principal and accrued interest at the effective date of the Plan—15% in General Mortgage 4½% Income Bonds, Series B, 60% in 5% Preferred Stock, and 25% in Common Stock (Tr. 1317, 1341).

It is to be noted:

A. that the General Mortgage Bonds lose 75% of their first lien position and their fixed interest charge and

the Fifty Year Bonds lose 100% of their first lien position and their fixed interest charge;

B. that all the General Mortgage Bonds, regardless of Series, are treated alike, although the interest rates upon the different Series vary between a low of 3½% and a high of 4¾% with the discriminatory result that certain Series receive higher aggregate interest on the new securities to be taken in exchange and other Series receive lower aggregate interest;

C. That all of the Fifty Year Bonds receive lower aggregate interest on the new securities than is borne by the Fifty Year Bonds;

D. that the General Mortgage Bonds are relegated to a stock position for 20% of their debt and the Fifty Year Bonds are so relegated for 85% of their debt; and

E. that all existing maturities of both the General Mortgage Bonds and the Fifty Year Bonds are either extended or eliminated by the substitution of stock (Tr. 2167; 2172; 2251; 2255).

No compensation is offered for these radical changes in the character and strategic positions of the General Mortgage Bonds and the Fifty Year Bonds; but, nevertheless, Adjustment Mortgage Bonds in the principal amount of $182,873,693, secured by an indenture *wholly* subordinate to both the General Mortgage and the Fifty Year Mortgage are offered 1,788,655 shares of new Common Stock without par value which (taken at $100 per share) represent an investment of $178,865,500 (Tr. 2172; 2257; 1317).

Although no provision is made under the Plan of Reorganization for the Railroad Company's Preferred and Common Stock, the Interstate Commerce Commission made no Finding of value of the Railroad Company's properties as a whole and under the Supplemental Opinion of the Circuit Court of Appeals a specific Finding of value is held to be unnecessary, in this respect creating a direct conflict with the decision of the Circuit Court of Appeals for the Ninth Circuit in the matter of The Western Pacific Railroad Company, filed November 28, 1941 (Tr. 2335).

The Cross Petitioner submits that these provisions of the Plan of Reorganization and the treatment accorded the Railroad Company's security holders (none of which provisions is required to be modified as a consequence of the Opinion and decision of the Circuit Court of Appeals) involve specific departures from the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois,* disregard the fundamental requirements of subsection (e) of Section 77 of the Bankruptcy Act and create confusion as to the law of the land in matters vitally affecting the public interest.

Other considerations will be presented in the annexed supporting Brief.

WHEREFORE, the Cross Petitioner respectfully prays that a *writ of certiorari* issue to the United States Circuit Court of Appeals for the Seventh Circuit, commanding said Court to certify and send to this Court, on a day to be determined, a full and complete transcript of the record of all of the proceedings had in this cause, to the end that this cause may be reviewed and determined by this Court; that the decree of the Circuit Court of Appeals and the decree of the District Court be reversed; and that this proceeding

be referred back to the Interstate Commerce Commission for reconsideration under the provisions of subsection (d) of Section 77 of the Act of Congress commonly known as the Bankruptcy Act, and further action in conformity with the decision and determination of this Court.

Dated, New York, N. Y., March 16, 1942.

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Brief in Support of Cross Petition

A true appraisal of the Opinion of the Circuit Court of Appeals filed as the basis of its decision in this Proceeding which the Railroad Company asks be reviewed by this Court must start with the premise that the Circuit Court of Appeals, notwithstanding the reversal of the District Court and its reference of the proceeding back to the Interstate Commerce Commission has, with a single possible exception, given its unqualified legal approval of the Plan of Reorganization substantially as certified to the District Court by the Interstate Commerce Commission. The Court, after referring to the decisions in *Consolidated Rock Products Company* v. *Du Bois,* and *Case* v. *Los Angeles Lumber Products Company,* 308 U. S. 106, says:

> "* * * We find nothing in either case which would defeat the plan here in question, *provided the evidence, and necessary findings are made, based on such evidence, and they establish the fairness of the plan.*" (Our italics.) (Tr. 2308.)

It is obvious, therefore, that the proceeding is to be sent back, not to conform the *Plan* to the fundamental requirements of the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois,* but merely for the purpose of revamping the record and underlying data to meet the procedural requirements of that decision; and, in the *Per Curiam* Supplemental Opinion filed January 12, 1942, the Court even relaxes those requirements to the extent of dispensing with any specific Finding of the value of the Railroad Company's property as a whole.

Again in dealing with the provisions made in the Plan for the General Mortgage Bonds, the Circuit Court of Appeals says:

"Accepting, as we do, the necessity for a drastic reduction in indebtedness and interest requirements and realizing that each of these divisions, to a certain extent, depends upon the existence and business of other branches of the system, we are unable to say the evidence fails to establish the fairness of the plan so far as these bonds are concerned.

If the proposition were an original one, it is true, we can readily see how a larger percentage of the new plan first mortgage bonds might have been given to holders of the General Mortgage bonds. On the other hand, while there is a difference in the priorities of the first mortgage bonds and the Series A bonds of the new issue, this may be made up in increased interest rates of the new bonds, especially if the increased revenues of the company, as disclosed during the year 1941, are maintained even in part. There is, however, in our opinion, a serious question presented due to the small percentage (25%) of the First Mortgage bonds given to the holders of old General Mortgage bonds. Our suggestion is that if any revision should be made, this percentage might be increased and the percentage of Series B and preferred and common stock, reduced" (Tr. pp. 2312, 2313).

So we think it quite clear that the Circuit Court of Appeals has approved as lawful the Commission's Plan notwithstanding repeated references in its Opinion to the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois,* and its direct admonition that the Findings which it directs "must be so specific that the court may definitely see that in the new plan, provision for full compensation of cancelled old senior securities, and all prior preferred positions, is made" (Tr. 2315). This language is manifestly meaningless when, as noted in the prefixed Cross Petition, the Plan of Reorganization shows upon its

face that the Railroad Company's General Mortgage Bondholders and Fifty Year 5% Mortgage Bondholders (we quote Mr. Justice DOUGLAS) "have received an inferior grade of securities, inferior in the sense that the interest rate has been reduced, a contingent return has been substituted for a fixed one, the maturities have been in part extended and in part eliminated by the substitution of a Preferred Stock and their former strategic position has been weakened" and not only has "full compensatory provision" in respect of "those lost rights" not been made; but no compensation whatever has been suggested unless it be the Court's vague suggestion that higher interest rates might be placed upon the new Bonds.

That the treatment so accorded the General Mortgage Bonds and the Fifty Year 5% Mortgage Bonds, whose rights are prior in all respects to the Adjustment Mortgage Bonds, runs counter to the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois* cannot seriously be questioned unless the foregoing as well as the following language from the opinion of Mr. Justice DOUGLAS means something quite different from what it plainly says (the words within the parentheses being our own interpolations):

> "* * * Clearly, those prior rights are not recognized, in cases where stockholders (or junior creditors) are participating in the plan, if (senior) creditors are given only a face amount of inferior securities equal to the face amount of their claims. They must receive, in addition, compensation for the senior rights which they are to surrender. If they receive less than that full compensatory treatment, some of their property rights will be appropriated for the benefit of (junior creditors or) stockholders without compensation. That is not permissible." (pp. 528, 529).

The Plan in almost every major adjustment involves a wholly inadmissible inequality or other violation of the priorities both relative and absolute, all of which are impliedly if not expressly sanctioned by the Opinion of the Circuit Court of Appeals; and, unless this Court intervenes to settle the law, these infirmities are almost certain to reappear in and to invalidate such substitute Plan as a bewildered Interstate Commerce Commission shall hereafter formulate.

It may be admitted (and counsel would be lacking in the candor due this Court if they failed to admit) that the doctrine of absolute priority as asserted by the Court in *Consolidated Rock Products Company* v. *Du Bois* extends that doctrine beyond what we had theretofore assumed to be its fixed boundaries. Our assumption had been that it was permissible to allot junior lien bonds or even preferred stock in adjustment of senior debt and to reduce interest or convert fixed interest into contingent interest without making compensation therefor so long as the priority as regards future income was protected and preserved. It seems evident that we had misconceived the rule but even if there has been an extension or broadening of its application, the development is a salutary one in the direction of greater protection of property rights and more scrupulous respect for the inviolability of contract.

The Railroad Company accepts in its full vigor and with all of its implications the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois*. As a just corollary it asks that it and its security holders in the order of their rights and priorities be given all of the benefits implicit in that decision.

To give adequate compensation to the various issues of Mortgage Bonds whose sacrifices are as extreme as those here indicated places what manifestly is a heavy burden upon the Railroad Company's Preferred and Common Stock.

The Railroad Company is nevertheless prepared to assume that burden.

In spite of the pessimism which permeates the Opinion and Supplemental Opinion of the Circuit Court of Appeals and which reflects the shaken morale of the two Groups who for reasons it would be interesting to trace are supporting the Commission's Plan, the Railroad Company maintains that rail transportation is not a decadent industry but is on the contrary an industry conspicuously on the upgrade, an industry achieving results in operating economy and efficiency of a character and extent until recently unthought of even by its own experts. This is graphically shown by the figures in the Transcript and is given striking emphasis by the current published figures of all Class 1 Carriers—figures of which this Court will, we believe, unhesitatingly take judicial notice under authorities hereinafter cited.

Let us, in developing this idea, first point out what is disclosed by the Report of the Interstate Commerce Commission as the basis of its negative Finding that the Preferred Stock and Common Stock was without value.

After showing that the present cost of reproduction new and less depreciation and the original cost of the Railroad Company's properties and its investment therein and its value for the rate base under Section 19A of the Interstate Commerce Act all exceeded by wide or substantial

margins the amount of its indebtedness, the Interstate Commerce Commission said:

> "* * * The total debt of $626,926,331 corresponds approximately to an available income of $28,212,000 capitalized at the low rate of 4½ percent. Only in 1928 and 1929 was such earning power demonstrated. We think that the examiner erred in finding a prospective equity for the preferred stock on the basis of $24,459,932 of average available income during the period 1925-29. That amount exceeds the annual charges on the principal of the present debt but does not take into consideration the large accrual of unpaid interest; in addition, it greatly exceeds the amount earned in any year since 1929. Computations were made by counsel for the committee and introduced at the oral argument showing the interest charges on the total debt at more than $29,000,000 a year. We disagree with the debtor in its contention that the high earning power of the system only 10 years ago indicates the injustice of resolving all uncertainties for the future in such a manner as to forfeit the stock. There is no evidence whatever to indicate that a recovery of the earning power of 1928-29 is reasonably probable, and we regard it as a remote possibility only, which may not be utilized to support a finding that the debtor's stockholders have an equity. In view of the earnings situation it would be improper to give controlling weight to the fact that the indicated reproduction—cost value of the property exceeds the amount of debt. We find that the equity of the holders of the debtor's preferred stock and its common stock has no value and the holders of claims in classes 24 and 25, therefore, are not entitled to participate in the plan" (Tr. 2259, 2260).

From this it is clear that the Interstate Commerce Commission attempted no Finding of value and did not make

any effort, as this Court's opinion in *Consolidated Rock Products Company* v. *Du Bois* plainly indicates is imperative, "to value the whole enterprise by a capitalization of prospective earnings." All that the Interstate Commerce Commission did was to venture a guess that a recovery of the earning power of 1928 and 1929 was not likely to occur. Nor was there even a Finding as to the amount of the annual fixed and contingent interest ahead of the stock at the date of the Plan, a factor without which the existence or non-existence of value for the stock could not possibly be determined. The importance of this is apparent when the status of $79,550,055 of interest accrued but unearned on the Adjustment Bonds is left undetermined. In interpreting the Opinion of this Court in the *Consolidated Rock Products* case, the Circuit Court of Appeals seems to have assumed that unearned contingent interest should be excluded (Tr. 2308, clause (b)).

The Railroad Company respectfully submits that this proceeding should be referred back to the Interstate Commerce Commission under subsection (e) of Section 77 with an absolute and unconditional right on the part of the Railroad Company and any party in interest to file a new Plan and to support such new Plan with additional up to date evidence: and it respectfully challenges the power or right of the Circuit Court of Appeals to refer the proceeding back to the Interstate Commerce Commission under a mandate such as is proposed in its *Per Curiam* Supplemental Opinion purporting to give the Interstate Commerce Commission an unreviewable discretion to refuse to receive evidence which parties in interest may see fit to offer in the protection of their property rights. But, assuming for argument that the Circuit Court of Appeals does possess such power or right, we again respectfully

submit that its exercise in this proceeding was so unreasonable, so erroneous and so in conflict with controlling decisions of this Court as alone to justify the issue of a *writ of certiorari* under Rule 38 of this Court.

The effective date of the Plan is December 31, 1938. The last hearing in the Interstate Commerce Commission was March 22, 1938. The final submission to the Interstate Commerce Commission was on April 12, 1939, and the original Plan was released by the Interstate Commerce Commission on February 12, 1940 (Tr. 692-1158; 2153-2269).

This Court will, as we confidently believe, take judicial notice of two facts of great significance, first, that the evidence before the Interstate Commerce Commission was closed at the very lowest point of the economic recession which set in late in 1937 and that since that time railway earnings have increased progressively until they have reached a point unprecedented in the history of the industry.

In the case of *Atchison, Topeka and Santa Fe Railroad Company* v. *United States,* 284 U. S. 248, this Court said:

> "There can be no question as to the change in conditions upon which the new hearing was asked. Of that change we may take judicial notice. It is the outstanding contemporary fact, dominating thought and action throughout the country. As the Interstate Commerce Commission said in its recent report to the Congress, 'a depression such as the country is now passing through is a new experience to the present generation.' The Commission also recognized in that report 'the very large reductions in railroad earnings which have accompanied the economic depression,' and stated that 'the chief cause

> of these reductions has been loss of traffic.' For 'in such depressions the railroads suffer severely.' Their traffic is a barometer of general business conditions'' (p. 260).

If, as is here held, the Court will take judicial notice of the existence of a depression and its reaction upon the business and revenues of our railway transportation system, it must follow that it will take judicial notice of the ending of that depression and the vast economic changes underlying the present day unprecedented prosperity of our railways.

In the case of *Central Kentucky Natural Gas Co.* v. *Railroad Commission of Kentucky, et al.*, 290 U. S. 264, the Court reiterated the above rule and held that judicial notice may be taken of changes in values, costs of service, consumption of commodities, and reasonable return on invested capital which have taken place during the period in which a case is pending before a commission and in a District Court.

For the very restricted purpose of a Supporting Brief upon application for a *writ of certiorari,* it will be sufficient to limit the discussion to the earnings of the Railroad Company for 1941 and the month of January, 1942. As already pointed out, the Interstate Commerce Commission wiped out the Preferred Stock and Common Stock of the Railroad Company because it regarded as remote a recovery of the earning capacity shown in 1928 and 1929.

Let us consider this in the light of what has since happened.

In so doing we ask the Court to bear in mind that earning capacity consists of at least two factors—(1) the capacity to attract tonnage to the rails that will produce gross receipts or (as termed in railway accounting) Railway

Operating Revenues, and (2) the capacity to convert or translate Railway Operating Revenues into Net Railway Operating Income, which may be less or may be more but ordinarily closely approximates the Income Available for Fixed Charges.

The Interstate Commerce Commission failed to disclose which of these factors it had in mind when it made its ill-fated guess, but that is not now material because it is quite evident that it was wrong as to both.

In 1929, when Railway Operating Revenues reached the all-time high of $171,361,385, the Income Available for Fixed Charges was $30,128,682 (Debtor's Court Exhibit No. 5).

In 1941, the Railway Operating Revenues were only $139,646,122, but the Income Available for Fixed Charges, as shown by the published reports of the Trustees, actually reached $28,939,719.* This figure is, however, believed to have been artificially depressed by extraordinary maintenance in the month of November and by the inclusion in the month of December of the entire wage increase retroactive for four months to September 1, 1941, without, of course, any offset for the increases in passenger and express rates already granted, or the increase in freight rates announced March 2, 1942. The Railroad Company would, if permitted to do so, undertake to prove in the Interstate Commerce Commission that the true figure for 1941 should closely approximate, if not exceed, the estimate referred to in the Opinion of the Circuit Court of Appeals of $31,140,683 (Tr. 2310). But it is immaterial for present purposes whether the true Income Available for Fixed Charges for 1941 was $28,939,719, as published by the Trustees, or

* Figures filed January 26, 1942, with the Interstate Commerce Commission and contemporaneously released to the Press.

$31,140,683, as estimated by the Railroad Company, or something more, because either figure is sufficient to cover *all* interest charges in the same period on the basis of any fair calculation; so that all gains in 1942 and subsequent years over 1941 will reflect the earning power or value of the Railroad Company's present stock (Tr. 2259).

Passing then from 1941 into the present year, we find that in the month of January, 1942, Railway Operating Revenues increased more than 30% over the corresponding month of 1941 with the following significant result:

NET RAILWAY OPERATING INCOME
1942 v. *1941*

*1942**	*1941*	*Increase*
$3,004,388	$1,756,422	$1,247,966

It thus appears that Railway Operating Revenues are running ahead of 1929 and that Net Railway Operating Income has increased in January, 1942, to the extent of $1,247,966, notwithstanding full absorption of the recent wage increase and without the benefit of the 6% increase in freight rates announced by the Interstate Commerce Commission on March 2, 1942. If this gain is maintained throughout the year 1942 (we think it should be greatly exceeded) the Railway Operating Income for 1942 in excess of what was earned in 1941 should amount to $14,975,592, so that the income available for dividends, assuming the full increase to be subject to the 31% Federal tax and deducting $4,642,433 therefor, will be $10,333,159, an amount sufficient to provide for the 5% dividend on $119,307,300 of Preferred Stock and to leave $4,367,794 available for 1,174,060 shares of Common Stock.

* Figures filed February 26, 1942, with the Interstate Commerce Commission and contemporaneously released to the Press.

Certain features of this truly remarkable demonstration of earning capacity ought to be emphasized. First of all, it is quite apparent that the high net income in a very large measure results not from abnormal tonnage created by the war but from vastly increased operating efficiency and to that extent is permanent. The figures speak for themselves and are conclusive. A comparison of the figures for 1929 as against 1941 has already been supplied. The property earned approximately as much in 1941 as it earned in 1929 although Railway Operating Revenues in 1941 were $31,715,263 *less* than in 1929. A comparison between 1930 and 1941 is of equal significance. In 1930, with Railway Operating Revenues of $142,569,632, the property earned $18,979,408 as Available for Fixed Charges, whereas in 1941, with Railway Operating Revenues of only $139,696,122, the property earned as Available for Fixed Charges not less than $28,939,719. These factors are of vital importance under the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois* because they demonstrate beyond the possibility of legitimate controversy that "the past earnings record" which was the Commission's only guide when it determined to extinguish the stock was not "a reliable criterion of future performance" (Opinion of Mr. Justice DOUGLAS, at p. 526). For that reason, if for no other, the proceeding should, we submit, be remanded to the Interstate Commerce Commission with directions to make a thorough-going study of the causes underlying the greatly increased capacity of the Railroad Company to translate gross revenue into net income and to include the results of its study as part of the factual data supporting its valuations under subsection (e) of Section 77 of the Railroad Company's properties as a whole and by mortgage sections.

Nor can the greatly increased tonnage which is moving over the Railroad Company's rails be disregarded in an appraisal of its earning power on the theory that the tonnage is an incident of the war and hence temporary. The fact is that it is the result of changed economic conditions, the duration of which no one can forecast. The war is only one of many factors but even the war may continue far into the future. Should it, as we all hope, end abruptly, inevitably it will be followed by a rebuilding program in Europe, in Asia, and elsewhere that may reasonably be expected to put upon our rails a traffic far in excess of any that could be measured by the past. The competition of the Panama Canal which heretofore was so devastating to the transcontinental railways is no longer significant and may never be restored. The world will need a new merchant marine to take the place of what is now being destroyed—millions of tons of iron and steel will move from our great industries to shipyards in the Pacific, the Atlantic, the Gulf of Mexico and the Great Lakes. These and other obvious sources of tonnage should assure for a period at least equal to the full service life of their present rails a splendid prosperity for our rail transportation systems.

The Railroad Company respectfully submits that this proceeding should be referred back to the Interstate Commerce Commission, not only for a complete set of Findings supported by adequate underlying data giving effect to economic changes since its original Report, but also for a radical revision of the Plan of Reorganization to conform to the fundamental requirements of this Court's decision in *Consolidated Rock Products Company* v. *Du Bois.*

In order that this may be done, unclotured hearings should be held by the Interstate Commerce Commission.

All that the Railroad Company seeks on behalf of its creditors and stockholders is a fair chance at hearings of that character held under a mandate from this Court to prove in support of a fair, equitable and non-discriminatory Plan of Reorganization conforming to the requirements of *Consolidated Rock Products Company* v. *Du Bois* its vastly increased earning capacity as the basis of true valuations of its properties as a whole and by mortgage sections to the extent that earning capacity is a factor to be considered under the law of the land.

In conclusion, the Railroad Company wishes to emphasize that its position under Section 77 of the Bankruptcy Act is *quasi* judicial and that it may and does speak for and in a very large measure represent both creditors and stockholders. By the title as well as by the terms of Chapter VIII of the Bankruptcy Act of which Section 77 forms a part, the Statute is one (note Section 73) "for the relief of debtors"; but, as the very first step to be taken thereunder after the approval of the Petition, the Railroad Company, as the Debtor, is required to surrender its entire estate to one or more trustees whose appointment is made mandatory. Subject to one exception found in subsection (g) which provides for a dismissal of the proceeding if there is undue delay, the only means whereby the Railroad Company may retrieve and receive back its properties so placed in judicial custody and obtain the relief for which Section 77 provides is by securing the approval of a Plan of Reorganization which is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, is non-discriminatory and otherwise complies with Section 77. The Railroad Company is therefore just as much interested in developing a Plan that is fair and equitable to its creditors as it is in securing a Plan that

affords due recognition to its stockholders and it believes that when this proceeding is remanded to the Interstate Commerce Commission such a Plan of Reorganization giving it the relief which the Statute contemplates may readily be developed within the principles and requirements and subject to all of the limitations of *Consolidated Rock Products Company* v. *Du Bois.*

To this end it asks that a *writ of certiorari* issue in accordance with the prayer of its Cross Petition.

Respectfully submitted,

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March 16, 1942.

(39)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

32-39-47-51-52
Nos. ~~988~~, ~~1004~~, ~~1048~~, ~~1063~~, ~~1064~~
and ~~1065~~, ~~1070~~, and ~~1071~~
53-54 55

IN THE MATTER OF THE REORGANIZATION OF
CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC
RAILROAD COMPANY, *Debtor*

BRIEF OF GROUP OF INSTITUTIONAL INVESTORS AND MUTUAL SAVINGS BANK GROUP IN OPPOSITION TO PETITIONS OF DEBTOR AND PREFERRED STOCKHOLDERS COMMITTEE FOR CERTIORARI TO REVIEW FINDING THAT STOCK IS WITHOUT VALUE (NOS. 1048, 1070) AND STATEMENT IN RESPECT TO PETITIONS FOR CERTIORARI OF CERTAIN CREDITOR INTERESTS (NOS. 988, 1004, 1063, 1064 AND 1065, 1071)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

Nos. 988, 1004, 1048, 1063, 1064 and 1065, 1070, and 1071.

In the Matter of
CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, *Debtor.*

RECONSTRUCTION FINANCE CORPORATION, *Petitioner,*
vs.
CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, *et al.*, *Respondents.* — **No. 988**

CHICAGO, TERRE HAUTE AND SOUTHEASTERN RAILWAY COMPANY, *et al.*, *Petitioners,*
vs.
GROUP OF INSTITUTIONAL INVESTORS, *et al.*, *Respondents.* — **No. 1004**

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, *Debtor and Cross Petitioner,*
vs.
GROUP OF INSTITUTIONAL INVESTORS, *et al.*, *Respondents.* — **No. 1048**

TRUSTEES OF PRINCETON UNIVERSITY, *et al.*, constituting the "University Group" of General Mortgage Bondholders of Chicago, Milwaukee & St. Paul Railway Company, *Petitioners*,
vs.
GROUP OF INSTITUTIONAL INVESTORS, *et al.*, *Respondents.* — **No. 1063**

GUARANTY TRUST COMPANY OF NEW YORK, ETC., as Fifty Year Mortgage Trustees, *Petitioners*,
vs.
GROUP OF INSTITUTIONAL INVESTORS, ETC., *et al.*, *Respondents.*

E. STANLEY GLINES, ETC., as Fifty Year Mortgage Protective Committee, *Petitioners*,
vs.
GROUP OF INSTITUTIONAL INVESTORS, ETC., *et al.*, *Respondents.* — **Nos. 1064 and 1065**

H. C. ORTON, *et al.*, *Petitioners*,
vs.
GROUP OF INSTITUTIONAL INVESTORS, *et al.*, *Respondents.* — **No. 1070**

UNITED STATES TRUST COMPANY OF NEW YORK as Trustee of General Mortgage of Chicago, Milwaukee and St. Paul Railway Company dated May 1, 1889, *et al.*, *Petitioner*,
vs.
GROUP OF INSTITUTIONAL INVESTORS, ETC., *et al.*, *Respondents.* — **No. 1071**

BRIEF OF GROUP OF INSTITUTIONAL INVESTORS AND MUTUAL SAVINGS BANK GROUP IN OPPOSITION TO PETITIONS OF DEBTOR AND PREFERRED STOCKHOLDERS COMMITTEE FOR CERTIORARI TO REVIEW FINDING THAT STOCK IS WITHOUT VALUE (Nos. 1048, 1070) AND STATEMENT IN RESPECT TO PETITIONS FOR CERTIORARI OF CERTAIN CREDITOR INTERESTS (Nos. 988, 1004, 1063, 1064 and 1065, 1071)

The petition for writs of certiorari filed by the Groups on January 17, 1942 (Nos. 975–983) seeks a review and determination by the Court of all issues between the creditor interests.

The Solicitor General has filed a petition on behalf of the Reconstruction Finance Corporation urging that certiorari be granted in view of the "large public importance" of the questions presented. (No. 988) The Solicitor General has also filed a Memorandum on behalf of the Interstate Commerce Commission as *amicus curiae*, stating: "It is important to the efficient performance of the Commission's duties under Section 77 that the procedure to be followed and the findings to be made by the Commission should be established by a definitive decision of this Court." (Nos. 875–883 and 988)

All creditor interests which were appellants below, except two,[1] have filed petitions for certiorari, requesting that the Court specifically determine the particular issues with which they are respectively concerned. (Nos. 1004, 1063, 1064 and 1065, 1071)

The Chicago, Milwaukee, St. Paul and Pacific Railroad Company, debtor herein, and H. C. Orton, *et al.*, as a committee

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[1] The appellants below who have not asked certiorari are: (1) Union Trust Company, *et al.*, trustees and certain bondholders under the Gary mortgage (Circuit Court of Appeals No. 7610), and (2) certain adjustment mortgage bondholders (Circuit Court of Appeals No. 7611).

for the holders of preferred stock, request certiorari to review the finding of the Commission, which was affirmed and approved by both courts below, that the stock is without value. (Nos. 1048, 1070)

I.

STATEMENT IN RESPECT TO PETITIONS FOR CERTIORARI FILED BY INTERESTS REPRESENTING CERTAIN TERRE HAUTE BONDS, FIFTY-YEAR MORTGAGE BONDS AND GENERAL MORTGAGE BONDS. (Nos. 1004, 1063, 1064, AND 1065, AND 1071)

The petition for writs of certiorari filed in this proceeding by the Group of Institutional Investors and the Mutual Savings Bank Group (Nos. 875–883) embraces all of the issues between the creditors. We believe that the interests of the many classes of creditors in this complex railroad reorganization are so related and so interdependent that only by such a review can the Court determine whether the Commission's report meets all necessary formal requirements and whether the plan is fair and equitable.

Certain creditor interests have filed separate petitions for certiorari, each petition being confined to the treatment of the particular securities with which the respective moving parties are primarily concerned. Such petitions have been filed by creditors interested in the issues of the Chicago, Terre Haute and Southeastern Railway Company, the Fifty-Year Mortgage (5's of 1975), and the General Mortgage. The representatives of the Fifty-Year Mortgage Bonds who have filed a petition state that they do not object to the granting of the comprehensive writs of certiorari sought by the Groups, and recognize that "of necessity" the questions which they present in their separate petition would be included in the review sought by the Groups' petition.

The trustee and holders of General Mortgage Bonds who have filed petitions also state that they do not object to the granting of the petition of the Groups.

The Terre Haute interests likewise do not deny that the questions raised in their petition would of necessity be included in the review sought by the Groups' petition, but have also filed a petition seeking a review of the issues arising out of their particular claims. A limited review would not do justice to the broad problem awaiting solution. Neither, we believe, would it assure a fair determination of the narrow issues to which such a review would be restricted, because those issues involve relative rather than absolute rights.

The Circuit Court of Appeals held:

> "The plan as such, ignoring the absence of findings, has support in the evidence. It violates no requirement (save findings) announced in the Consolidated Rock Products case." (R. 2312)

The court's conclusion that findings were inadequate extends to all controversies between creditor interests. It does not extend to the exclusion by the Commission of the old common and preferred stock upon a finding that the equity of such stock was without value, that finding being held to be sufficient. As to the conflicts between creditor interests, our petition for certiorari is inclusive of all the controversies brought forward by the various petitions subsequently filed by other creditors. Our petition not only challenges the decision that the Commission's findings were inadequate, but also presents the proposition that, if the plan be deficient in supporting findings, as the Circuit Court of Appeals has held, it should be returned to the Commission with directions sufficiently clear and explicit to enable the administrative body to redraft it in such manner that it will receive the approval of the courts.

We submit that the petitions for review of the plan, filed by the Terre Haute creditors, the 5's of 1975 and the General Mortgage interests, emphasize the need for granting the comprehensive petition of the Group of Institutional Investors and the Mutual Savings Bank Group. If that petition were not to be granted we submit that all individual petitions should be denied.

II.

THE DEBTOR'S CROSS PETITION AND THE PETITION OF THE PREFERRED STOCKHOLDERS COMMITTEE FOR WRITS OF CERTIORARI SHOULD BE DENIED.

The provisions of the plan which deny any participation in the reorganized property to the common and preferred stocks because they are found to be without value, have been sustained by the District Court and the Circuit Court of Appeals.[1] We believe that the record made this conclusion inevitable, and that no question of substance can be raised as to its correctness. No dividends have been paid upon the common or preferred stock of this company since 1917 (R. 617), and it is clear now that the equity in the property lost its value many years ago. In the period from 1917 to the effective date of the plan, the income available for interest was $133,000,000 less than the amount required for interest on debt, or an average annual deficit for the 21 years of more than $6,000,000[2].

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[1] "A plan of reorganization," Section 77(b) provides, "may include provisions modifying or altering the rights of stockholders generally, or any class of them, either through the issuance of new securities of any character, or otherwise;**" Subsection (e) of Section 77 provides that: "submission to any class of stockholders shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, * * * that at the time of the finding the equity of such class of stockholders has no value * * *."

[2] The net income available for dividends or deficit therein for each of the years from 1910 through 1937 was listed in the debtor's brief of May 31, 1938, before the Commission. (p. 10) The deficit in income available for dividends for the 20 years from 1917 through 1937 was $115,596,701.39. The income available for interest in 1938 was $6,023,296 (R. 2180), and the interest charges on debt were $23,739,279 (R. 2174), leaving a deficit in the income available for dividends of $17,715,983. For the entire 21-year period from 1917 through 1938 the deficit in income available for dividends therefore amounted to $133,312,684, or an average annual deficit of $6,348,223.

Throughout that period, therefore, the debt of the property has greatly increased both in relation to its earnings and in absolute terms. (R. 1873, 2180) The debt condition of the property was not rectified by the 1928 receivership. On the contrary, the railroad emerged from that receivership with an actual increase in its funded debt requirements. (Chicago, Milwaukee & St. Paul Reorganization, 131 I.C.C. 673, 705) Even at the time of that receivership the stock had neither earned nor received dividends for many years; and it is clear now, we believe, that the stock interests should not have survived that receivership.

The issue as to the stock is the only one in the proceeding as to which the court below found that the determination of the Commission was supported by adequate findings. This feature of the case, therefore, is closed (R. 2335), and unless the Court grants certiorari the determination of at least this issue will have been achieved by the seven years of litigation. To this end the Groups oppose the petition of the debtor, and the petition of H. C. Orton, *et al.*, as a committee for the holders of preferred stock, and request denial of the writs of certiorari prayed for by them to review the finding of the Commission, affirmed by both courts below, that the stock is without value.

NO SUBSTANTIAL CONTROVERSY EXISTS IN RESPECT TO THE FINDING THAT THE STOCK IS WITHOUT VALUE

The finding of the Commission that the stock is without value was made after full and protracted hearings and upon a most comprehensive record. The Trustees in Bankruptcy and their staff offered extensive studies and testimony. The Commission placed in the record much basic data prepared by its own staff relating to the elements of physical value of the property, its traffic, and its past, present and prospective earning capacity. (Reports of Interstate Commerce Commission's Bureau of Valuation, Bureau of Finance and Bureau of Finance Accountants, which are parts of the record but not reprinted. R. 2151.)

The finding of the Commission that the stock is without value is explicit and the report contains a full statement of the Commission's reasons for that conclusion, as the statute requires. (Sec. 77(e)) The petitions for certiorari of the debtor and the preferred stockholders do not raise any question of substance, either as to the existence of evidence to support the Commission's finding or as to the adequacy of its findings.

(*a*) *Finding by the Interstate Commerce Commission.*

The report of the Commission approving the plan of reorganization, which was duly certified to the court, provided:

> "We find that the equity of the holders of the debtor's preferred stock and its common stock has no value and the holders of claims in classes 24 and 25, therefore, are not entitled to participate in the plan." (R. 2260)

Such a finding is sufficient even apart from the specific provisions of Section 77. *In re 620 Church Street Building Corp.*, 299 U.S. 24 (1936); *R. R. Commission* v. *P. G. & E. Co.*, 302 U.S. 388 (1938).

The "reasons" for this conclusion were stated fully by the Commission in its report approving a plan of reorganization, in strict conformity with the provisions of Section 77(e). (R. 2258–2260) In addition to the reasons quoted on page 14 of the debtor's cross petition, the following reasons, among others, are stated by the Commission in support of its conclusion that the stock is without value:

(1) "The last year when dividends were paid on the stock was in 1917." (R. 2259)

(2) "The record of the Milwaukee's earnings" from 1910 through 1938 supports the finding that the stock is without value. (R. 2259, referring to earlier statement in Commission's report on R. 2180.)

(3) "Between 1930 and 1936 the income available for payment of interest, as adjusted by the committee and accepted by the debtor, varied between a high level of

$20,298,074 and a low of $2,680,530, with an average of $10,270,360. Similarly adjusted, the available income in 1937 was $8,224,809 and in 1938 $6,023,296, bringing the average, 1930 to 1938, to $9,571,180. Future normal earnings were estimated by the committee at $15,894,000 a year. When these amounts are compared with the annual interest charges on the principal of the present debt, $23,739,000 a year, it is evident that the earning power of the system since the period of peak earnings is entirely inadequate to cover the principal of the debt, disregarding more than $118,000,000 of unpaid interest." (R. 2259)

(4) "We are required under section 77(e) to make findings in connection with the question of submitting the plan to the stockholders, and in doing so we must consider the aggregate amount of claims of the bondholders and other secured creditors in the light of the earning power of the system, past, present, and prospective, and all relevant facts. Unless an equity for the stockholders is established we are unable to find justification for their participation in the plan. Case v. Los Angeles Lumber Products Co., U.S. (Decided November 6, 1939)." (R. 2260)

These are some of the reasons stated by the Commission in its report for finding that the stock is without value and that the holders thereof are not entitled to participate in the plan.

(*b*) *Affirmance by the District Court.*

The order of the District Court approving the plan provided:

"The Finding of the Commission that the equity of the Preferred and Common Stockholders of the Debtor has no value is affirmed." (R. 1991)

The debtor's cross petition makes no effort to controvert any of the controlling reasons stated by the District Court for thus affirming the finding that the stock is without value. In so doing the court considered not only the evidence certified by the Commission but also the voluminous oral and documentary evidence introduced in court. Some of the reasons stated by the court on the basis of this comprehensive evidence were:

(1) "The record shows that no dividends have been paid upon the stock of the Debtor or its predecessor since 1917." (R. 1873)

(2) "Even in the ten-year period ending with 1930, which included the peak years of 1928 and 1929, income available for interest fell far short of the amount needed to service the funded debt which was less than on January 1, 1939, the effective date of the Plan. This condition has been brought about not entirely by the financial depression but has been contributed to by many factors such as increased costs, taxes, wages, competition in other forms of transportation and the like. In no year since 1930 has the income available for interest been equal to the amount required under the proposed Plan to meet charges ahead of dividends." (R. 1873)

(3) "The objectors [the debtor and the preferred stockholders committee] do not dispute any of the facts embodied in the elements considered by the Commission in reaching its conclusions but the contention is made that the outlook for the future is bright and the prospect for increased earnings promising and this situation, it is claimed, justifies a finding of some value for the equity owners. An expert was called who voiced this view and expressed at some length his opinion as to future earnings. That witness expressed the view that the Debtor's properties were efficiently operated and were in good physical condition and that he felt, in the light of the present tendencies, that it was not too much to expect that a time might be reached, some time in the future, when the railroad might earn a sufficient amount to have available for the payment of interest $20,300,000. That time was referred to as the future normal year but the witness was unwilling even to venture a guess when such time might arrive. Moreover, if such an amount were earned and available for the payment of interest, the capitalization of this amount at four per cent would produce slightly over $500,000,000 which is a less amount than the permissible capitalization fixed by the Commission. Under the Plan approved by the Commission, if $20,300,000 were available for the payment of interest, there would only be

enough to pay dividends on the new preferred stock and none on the new common, assuming the additional amount for additions and betterments contemplated by the Plan were authorized by the Board of Directors, and the preferred stock under the Plan represents the interest of present bondholders. If applied to the existing indebtedness, including unpaid accrued interest to January 1, 1939, such an amount would fall short by some $9,000,000 of paying interest at the average existing rate carried by the obligations of the Debtor." (R. 1873–4)

(c) *Approval by the Circuit Court of Appeals.*

On the record before it, the Circuit Court of Appeals passed on the finding that the equity has no value, in precise and categorical terms, and sustained the action of the Commission and the District Court in respect thereto, stating in part:

> "We are well satisfied that the evidence supports the finding of the Commission approved by the District Court 'that the equity of the holders of the debtor's preferred stock and its common stock has no value.' * * *
>
> "If the Commission gave value to the common and preferred stock, it would have violated one of the first requirements of a valid reorganization as announced in the Consolidated Rock Products Company case. It would have taken property from the mortgagees and given it to the stockholders, an act which would not only have violated the law but would have transgressed all the rules of fairness which must be at the bottom of all reorganization plans." (R. 2311)

On Motion to Modify the Opinion, the Circuit Court of Appeals further held on January 12, 1942:

> "Now, to make our position entirely clear, we add this memorandum and hold that the finding of the I.C.C. as to absence of value of old common and preferred stock, is specific, definite and certain, and fully meets the rule which requires finding on values of assets.

> "Second, we meant to hold, and do hold, that the evidence supports this finding, that there is no value to either the common or preferred stock of debtor * * *." (R. 2335)

These conclusive reasons for the finding that the stock is without value, as stated by the Commission and both courts below, are not controverted by the stock interests. They do not deny that since this property ceased to pay dividends in 1917 its earnings have failed to meet the interest requirements on its debt by an average annual amount of more than $6,000,000. Neither may they deny that the average normal prospective earnings estimated by the debtor's own witness in September, 1940, would fall short of meeting interest requirements by approximately $9,000,000 annually. (Opinion, District Court, R. 1873–4) Faced with these past and prospective earnings, the debtor states that it prefers "to limit the discussion to the earnings of the Railroad Company for 1941 and the month of January, 1942." (Debtor's Cross Petition, p. 17)[1] Substantially the same contention was presented to and rejected by the court below. The court stated:

> "This finding [that the stock is without value] is sharply challenged by the old stockholders who point to the present, sharp upturn of business activities, particularly railroads, stating that the first eight months of 1941 show an increase in gross operating revenues over 1940 of 22.8%, and estimate that the income available for fixed

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[1]The preferred stockholders committee states that "The Commission * * * refused to consider any evidence of physical value." (Petition of Preferred Stockholders Committee, p. 8.) Apparently the committee overlooked the fact that the Commission itself placed in the record the findings of its Bureau of Valuation showing the elements of value of the physical property, and both in discussing the value of the debtor's properties as a whole and in concluding that the stock is without value, found: "The reproduction cost of the system properties * * * was $662,759,838." (R. 2164, 2259)

> charges for 1941 will be $31,140,683.[1] * * * We are well satisfied that the evidence supports the finding of the Commission approved by the District Court 'that the equity of the holders of the debtor's preferred stock and its common stock has no value.' And this is true even though the evidence of current earnings made since the plan was approved, is received and considered." (R. 2310–2311)

Reliance by the stock interests upon wartime traffic and earnings disregards past experience. The Interstate Commerce Commission has characterized wartime traffic and earnings thus: "We know from past experience that the upswing in business which war brings is temporary and likely to be followed by an aftermath in which conditions will be worse than before." (Fifty-third Annual Report of Interstate Commerce Commission to Congress, p. 5.) One aftermath of World War I was a substantial reduction in the earnings of this property. (Chicago, Milwaukee & St. Paul Reorganization, 131 I.C.C. 673, 715.)

Less than a month ago the Interstate Commerce Commission, in refusing to increase the new capitalization authorized by it for another railroad undergoing reorganization, because of the bulge in earnings in the first six months of 1941, stated that such earnings were "abnormal owing to threatening war conditions, and cannot serve as a basis for the formulation of a plan of reorganization." (Supplemental Report of Interstate Commerce Commission and St. Louis Southwestern Railway Company Reorganization, Finance Docket No. 11040, dated March 9, 1942, p. 5.)

Here, likewise, the Court is asked to disregard the earnings of the past, and the normal earning capacity of the property in the future, and to require that the Commission base a plan of

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[1] The amount now stated by the debtor as the Income Available for Fixed Charges in 1941 is less by $2,200,964 than that estimated by the debtor in the Circuit Court of Appeals. (Debtor's Cross Petition, p. 18)

reorganization upon the earnings of the railroad company "for 1941 and the month of January, 1942," the showing upon which the debtor rests its petition for certiorari. (Brief, March 31, 1942, p. 17.) We submit that such a contention does not present a question of substance for this Court and ask that the petitions for certiorari of the debtor and the preferred stockholders be denied.

Respectfully submitted,

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